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AMENDED IN SENATE MARCH 20, 2002

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AMENDED IN ASSEMBLY APRIL 4, 2001

CALIFORNIA LEGISLATURE—2001–02 REGULAR SESSION

ASSEMBLY BILL

No. 1122

Introduced by Assembly Member Corbett

(Principal coauthor: Assembly Member Matthews)

(Coauthors: Assembly Members Alquist, Aroner, Cardenas, Chan, Chu, Frommer, Keeley, Kehoe, Koretz, Lowenthal, Matthews, Nakano, Pavley, Salinas, Strom-Martin, Thomson, and Wiggins)

February 23, 2001

~~An act to amend Sections 17024.5, 17039, 17052.6, 17052.12, 17062, 17063, 17085, 17140, 17140.3, 17275.5, 17501, 17551, 17560, 17570, 17731.5, 17751, 18038.5, 19136, 19141, 19365, 19521, 23038.5, 23456, 23457, 23609, 23701s, 23705, 23711, 23712, 23801, 23802, 23811, 24357.9, 24424, 24443, 24667, 24710, and 24942 of, to amend and repeal Section 24949.1 of, to add Sections 17062.3, 17132, 17132.6, 17144.5, 17205, 17552.3, 17563.5, 19136.8, 23456.5, 24661.3, and 24685.5 to, and to repeal Sections 17271 and 17279.5 of, the Revenue and Taxation Code, relating to taxation, to take effect~~

~~immediately, tax levy.~~ *An act to amend Sections 17024.5, 17052.6, 17052.12, 17062, 17063, 17073, 17085, 17140, 17140.3, 17144, 17152, 17279, 17279.4, 17501, 17551, 17570, 17751, 17752, 17760.5, 18521, 19136, 19365, 23038.5, 23051.5, 23456, 23457, 23609, 23701s, 23705, 23711, 23712, 23800.5, 23801, 23802, 23806, 23811, 24273, 24306, 24307, 24349, 24355.5, 24357, 24362, 24364, 24369.4, 24407, 24409, 24423, 24426, 24651, 24674, 24710, 24872.4, 24944, 24946, and 24949.2 of, to add Sections 17144.5, 17205, 17207.5, 19136.8, and 24347.6 to, to repeal Section 18037 of, and to repeal and add Sections 24377, 24676, and 24676.5 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.*

LEGISLATIVE COUNSEL'S DIGEST

AB 1122, as amended, Corbett. Taxation: federal conformity.

Under existing Personal Income Tax Law and the Bank and Corporation Tax Law a taxpayer, generally, has the option to treat specified transactions differently than the manner in which the transaction was elected to be treated for federal income tax purposes.

This bill would provide, with specified exceptions, that any election made for federal income taxes would apply for state income tax purposes.

This bill would, for purposes of the Personal Income Tax Law or the Bank and Corporation Tax Law, or both, make certain other changes in conformance with federal law, as specified, with respect to the dependent care expense credit, the treatment of gifts of appreciated property, the penalties imposed for underpayments of estimated taxes, credit for research and development costs, election to treat outdoor advertising displays as real property, filing status, Commodity Credit Corporation loans, charitable contribution deduction, amortizable bond premium, certain expenses chargeable to capital account, certain expenditures by farmers, deduction for organizational expenditures of a corporation, intangible drilling and development costs, election to capitalize certain taxes and carrying charges, certain methods of accounting, certain non-interest-bearing and other obligations, prepaid subscription income, magazines, paperbacks, and records returned after the close of the taxable year, qualified tuition programs, the compulsory or involuntary conversion of property, and the election relating to replacement property or stock.

The Personal Income Tax Law, in partial conformity with federal law, provides tax benefits for contributions to specified retirement plans.

This bill would, in conformance with the Economic Growth and Tax Relief Reconciliation Act of 2001, expand the tax benefits allowed for contributions to these retirement plans.

This bill would take effect immediately as a tax levy.

~~Under the Personal Income Tax Law and the Bank and Corporation Tax Law, various provisions of the federal Internal Revenue Code, as enacted as of a specified date, are referenced in various sections of the Revenue and Taxation Code. Those laws provide that for taxable years beginning on or after January 1, 1998, the specified date of those referenced Internal Revenue Code sections is January 1, 1998, unless otherwise specifically provided.~~

~~Existing law requires, for any introduced bill that proposes changes in any of those dates, that the Franchise Tax Board prepare a complete analysis of the bill that describes all changes to state law that will automatically occur by reference to federal law as of the changed date. It further requires the Franchise Tax Board to immediately update and supplement that analysis upon any amendment to the bill, and requires that analysis to be made available to the public and to be submitted to the Legislature for publication in the daily journal of each house of the Legislature.~~

~~This bill would change the specified date of those referenced Internal Revenue Code sections to January 1, 2001, for taxable years beginning on or after January 1, 2002, and thereby would make numerous substantive changes to both the Personal Income Tax Law and the Bank and Corporation Tax Law with respect to those areas of preexisting conformity that are subject to changes under federal laws enacted after January 1, 1998, and that have not been, or are not being, excepted or modified.~~

~~This bill would make certain other changes in federal income tax laws applicable, with specified exceptions and modifications, and make specified supplemental, technical, or clarifying changes, for purposes of the Personal Income Tax Law or the Bank and Corporation Tax Law, or both, with respect to, among other things, credits that may reduce certain taxes below the tentative minimum tax, the credit for dependent care expenses, the credit for research and development expenses, adjustments in computing alternative minimum taxable income, the exclusion of extraterritorial income, annuities and certain proceeds of life insurance contracts, the Ricky Ray Hemophilia Relief Fund Act of~~



~~1998, the denial of deduction for club dues, the mark to market accounting method, the inapplicability of excise tax on premiums paid, certain amounts paid in connection with insurance contracts, specified federal acts, the installment method of accounting, qualified state tuition programs, the Federal Agriculture Improvement and Reform Act of 1996, determinations relating to deferred compensation, taxation of estates and trusts, small business stock, failure by an individual to pay estimated income tax, underpayment of estimated tax, underpayments of installments, elimination of interest on overlapping periods of tax overpayments and underpayments, mining exploration and development costs, tax-exempt interest, "S corporations," certain publicly traded partnerships treated as corporations, the deduction for a qualified computer contribution, secured indebtedness, tax on passive investment income, securities futures contracts, and the sale or exchange of livestock. This bill would specify various dates on which specified provisions apply, make findings and declarations that certain provisions are declaratory of existing law, and specify the intent and operation in the application of provisions conforming to various federal acts.~~

~~The Personal Income Tax Law, in partial conformity with federal law, provides tax benefits for contributions to specified retirement plans.~~

~~This bill would, in conformance with the Economic Growth and Tax Relief Reconciliation Act of 2001, expand the tax benefits allowed for contributions to these retirement plans.~~

~~This bill would take effect immediately as a tax levy but would become operative only if SB 657 is chaptered.~~

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 ~~SECTION 1. Section 17024.5 of the Revenue and Taxation~~
- 2 ~~SECTION 1. Section 17024.5 of the Revenue and Taxation~~
- 3 ~~Code is amended to read:~~
- 4 ~~17024.5. (a) (1) Unless otherwise specifically provided, the~~
- 5 ~~terms "Internal Revenue Code," "Internal Revenue Code of~~
- 6 ~~1954," or "Internal Revenue Code of 1986," for purposes of this~~
- 7 ~~part, mean Title 26 of the United States Code, including all~~

amendments thereto as enacted on the specified date for the applicable taxable year as follows:

Taxable Year	Specified Date of Internal Revenue Code Sections
(A) For taxable years beginning on or after January 1, 1983, and on or before December 31, 1983	January 15, 1983
(B) For taxable years beginning on or after January 1, 1984, and on or before December 31, 1984	January 1, 1984
(C) For taxable years beginning on or after January 1, 1985, and on or before December 31, 1985	January 1, 1985
(D) For taxable years beginning on or after January 1, 1986, and on or before December 31, 1986	January 1, 1986
(E) For taxable years beginning on or after January 1, 1987, and on or before December 31, 1988	January 1, 1987
(F) For taxable years beginning on or after January 1, 1989, and on or before December 31, 1989	January 1, 1989
(G) For taxable years beginning on or after January 1, 1990, and on or before December 31, 1990	January 1, 1990
(H) For taxable years beginning on or after January 1, 1991, and on or before December 31, 1991	January 1, 1991
(I) For taxable years beginning on or after January 1, 1992, and on or before December 31, 1992	January 1, 1992
(J) For taxable years beginning on or after January 1, 1993, and on or before December 31, 1996	January 1, 1993
(K) For taxable years beginning on or after January 1, 1997, and on or before December 31, 1997	January 1, 1997
(L) For taxable years beginning on or after January 1, 1998	January 1, 1998

(2) Unless otherwise specifically provided, for federal laws enacted on or after January 1, 1987, and on or before the specified date for the taxable year, uncodified provisions that relate to provisions of the Internal Revenue Code that are incorporated for purposes of this part shall be applicable to the same taxable years as the incorporated provisions.

(3) Subtitle G (Tax Technical Corrections) and Part I of Subtitle H (Repeal of Expired or Obsolete Provisions) of the Revenue Reconciliation Act of 1990 (Public Law 101-508) modified

1 numerous provisions of the Internal Revenue Code and provisions
2 of prior federal acts, some of which are incorporated by reference
3 into this part. Unless otherwise provided, the provisions described
4 in the preceding sentence, to the extent that they modify provisions
5 that are incorporated into this part, are declaratory of existing law
6 and shall be applied in the same manner and for the same periods
7 as specified in the Revenue Reconciliation Act of 1990.

8 (b) Unless otherwise specifically provided, when applying any
9 provision of the Internal Revenue Code for purposes of this part,
10 a reference to any of the following shall not be applicable for
11 purposes of this part:

12 (1) Except as provided in Chapter 4.5 (commencing with
13 Section 23800) of Part 11 of Division 2, an electing small business
14 corporation, as defined in Section 1361(b) of the Internal Revenue
15 Code.

16 (2) Domestic international sales corporations (DISC), as
17 defined in Section 992(a) of the Internal Revenue Code.

18 (3) A personal holding company, as defined in Section 542 of
19 the Internal Revenue Code.

20 (4) A foreign personal holding company, as defined in Section
21 552 of the Internal Revenue Code.

22 (5) A foreign investment company, as defined in Section
23 1246(b) of the Internal Revenue Code.

24 (6) A foreign trust, as defined in Section 679 of the Internal
25 Revenue Code.

26 (7) Foreign income taxes and foreign income tax credits.

27 (8) Section 911 of the Internal Revenue Code, relating to
28 United States citizens living abroad.

29 (9) A foreign corporation, except that Section 367 of the
30 Internal Revenue Code shall be applicable.

31 (10) Federal tax credits and carryovers of federal tax credits.

32 (11) Nonresident aliens.

33 (12) Deduction for personal exemptions, as provided in
34 Section 151 of the Internal Revenue Code.

35 (13) The tax on generation-skipping transfers imposed by
36 Section 2601 of the Internal Revenue Code.

37 (14) The tax, relating to estates, imposed by Section 2001 or
38 2101 of the Internal Revenue Code.

39 (c) (1) The provisions contained in Sections 41 to 44,
40 inclusive, and 172 of the Tax Reform Act of 1984 (Public Law

98-369), relating to treatment of debt instruments, shall not be applicable for taxable years beginning before January 1, 1987.

(2) The provisions contained in Public Law 99-121, relating to the treatment of debt instruments, shall not be applicable for taxable years beginning before January 1, 1987.

(3) For each taxable year beginning on or after January 1, 1987, the provisions referred to by paragraphs (1) and (2) shall be applicable for purposes of this part in the same manner and with respect to the same obligations as the federal provisions, except as otherwise provided in this part.

(d) When applying the Internal Revenue Code for purposes of this part, regulations promulgated in final form or issued as temporary regulations by “the secretary” shall be applicable as regulations under this part to the extent that they do not conflict with this part or with regulations issued by the Franchise Tax Board.

(e) Whenever this part allows a taxpayer to make an election, on or after January 1, 2002, in taxable years beginning on or after January 1, 2002, the following rules shall apply:

(1) A proper election for federal income tax purposes filed with the Internal Revenue Service in accordance with the Internal Revenue Code or regulations issued by “the secretary” shall be treated as an election for purposes of this part and a separate election for state purposes shall not be allowed.

(2) A copy of that election shall be furnished to the Franchise Tax Board upon request.

(3) If a taxpayer does not make a proper election for federal income tax purposes, a separate election for purposes of this part shall not be allowed unless otherwise provided in this part.

(f) Whenever this part allows or requires a taxpayer to file an application or seek consent, the rules set forth in subdivision (e) shall be applicable with respect to that application or consent.

(g) When applying the Internal Revenue Code for purposes of determining the statute of limitations under this part, any reference to a period of three years shall be modified to read four years for purposes of this part.

(h) When applying, for purposes of this part, any section of the Internal Revenue Code or any applicable regulation thereunder, all of the following shall apply:

1 (1) References to “adjusted gross income” shall mean the
2 amount computed in accordance with Section 17072, except as
3 provided in paragraph (2).

4 (2) References to “adjusted gross income” for purposes of
5 computing limitations based upon adjusted gross income, shall
6 mean the amount required to be shown as adjusted gross income
7 on the federal tax return for the same taxable year.

8 (3) Any reference to “subtitle” or “chapter” shall mean this
9 part.

10 (4) The provisions of Section 7806 of the Internal Revenue
11 Code, relating to construction of title, shall apply.

12 (5) Any provision of the Internal Revenue Code that becomes
13 operative on or after the specified date for that taxable year shall
14 become operative on the same date for purposes of this part.

15 (6) Any provision of the Internal Revenue Code that becomes
16 inoperative on or after the specified date for that taxable year shall
17 become inoperative on the same date for purposes of this part.

18 (7) Due account shall be made for differences in federal and
19 state terminology, effective dates, substitution of “Franchise Tax
20 Board” for “secretary” when appropriate, and other obvious
21 differences.

22 (i) Any reference to a specific provision of the Internal
23 Revenue Code shall include modifications of that provision, if any,
24 in this part.

25 *SEC. 2. Section 17052.6 of the Revenue and Taxation Code is*
26 *amended to read:*

27 17052.6. (a) For each taxable year beginning on or after
28 January 1, 2000, there shall be allowed as a credit against the “net
29 tax” (as defined in Section 17039) an amount determined in
30 accordance with Section 21 of the Internal Revenue Code, as
31 modified by the Economic Growth and Tax Relief Reconciliation
32 Act of 2001 (Public Law 107-16), except that the amount of the
33 credit shall be a percentage, as provided in subdivision (b) of the
34 allowable federal credit without taking into account whether there
35 is a federal tax liability.

36 (b) For the purposes of subdivision (a), the percentage of the
37 allowable federal credit shall be determined as follows:
38

	The percentage of
If the California adjusted gross income is:	credit is:
\$40,000 or less	63%
Over \$40,000 but not over \$70,000	53%
Over \$70,000 but not over \$100,000	42%
Over \$100,000	0%

(c) In the case of a taxpayer whose credits provided under this section exceed the taxpayer's tax liability computed under this part, the excess shall be credited against other amounts due, if any, from the taxpayer and the balance, if any, shall be paid from the Tax Relief and Refund Account and refunded to the taxpayer.

(d) For purposes of this section, California adjusted gross income means California adjusted gross income as computed for purposes of Section 17041.

(e) The credit authorized by this section shall be limited to those taxpayers who, during the taxable year, maintain a household, within the meaning of Section 21(e)(1) of the Internal Revenue Code, that is located within this state.

SEC. 2.5. Section 17052.12 of the Revenue and Taxation Code is amended to read:

17052.12. For each taxable year beginning on or after January 1, 1987, there shall be allowed as a credit against the "net tax" (as defined by Section 17039) for the taxable year an amount determined in accordance with Section 41 of the Internal Revenue Code, except as follows:

(a) For each taxable year beginning before January 1, 1997, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "8 percent."

(b) (1) For each taxable year beginning on or after January 1, 1997, and before January 1, 1999, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "11 percent."

(2) For each taxable year beginning on or after January 1, 1999, and before January 1, 2000, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "12 percent."

(3) For each taxable year beginning on or after January 1, 2000, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "15 percent."

1 (c) Section 41(a)(2) of the Internal Revenue Code, relating to
2 basic research payments, shall not apply.

3 (d) “Qualified research” shall include only research conducted
4 in California.

5 (e) In the case where the credit allowed under this section
6 exceeds the “net tax,” the excess may be carried over to reduce the
7 “net tax” in the following year, and succeeding years if necessary,
8 until the credit has been exhausted.

9 (f) (1) With respect to any expense paid or incurred after the
10 operative date of Section 6378, Section 41(b)(1) of the Internal
11 Revenue Code is modified to exclude from the definition of
12 “qualified research expense” any amount paid or incurred for
13 tangible personal property that is eligible for the exemption from
14 sales or use tax provided by Section 6378.

15 (2) For each taxable year beginning on or after January 1, 1998,
16 the reference to “Section 501(a)” in Section 41(b)(3)(C) of the
17 Internal Revenue Code, relating to contract research expenses, is
18 modified to read “this part or Part 11 (commencing with Section
19 23001).”

20 (g) (1) For each taxable year beginning on or after January 1,
21 1998, and before January 1, 2000:

22 (A) The reference to “1.65 percent” in Section 41(c)(4)(A)(i)
23 of the Internal Revenue Code is modified to read “one and
24 thirty-two hundredths of one percent.”

25 (B) The reference to “2.2 percent” in Section 41(c)(4)(A)(ii)
26 of the Internal Revenue Code is modified to read “one and
27 seventy-six hundredths of one percent.”

28 (C) The reference to “2.75 percent” in Section 41(c)(4)(A)(iii)
29 of the Internal Revenue Code is modified to read “two and
30 two-tenths of one percent.”

31 (2) For each taxable year beginning on or after January 1, 2000:

32 (A) The reference to “1.65 percent” in Section 41(c)(4)(A)(i)
33 of the Internal Revenue Code is modified to read “one and
34 forty-nine hundredths of one percent.”

35 (B) The reference to “2.2 percent” in Section 41(c)(4)(A)(ii)
36 of the Internal Revenue Code is modified to read “one and
37 ninety-eight hundredths of one percent.”

38 (C) The reference to “2.75 percent” in Section 41(c)(4)(A)(iii)
39 of the Internal Revenue Code is modified to read “two and
40 forty-eight hundredths of one percent.”

(3) Section 41(c)(6) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(h) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(i) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other taxable years under the rules of subdivision (e); except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent taxable year.

SEC. 3. Section 17062 of the Revenue and Taxation Code is amended to read:

17062. (a) In addition to the other taxes imposed by this part, there is hereby imposed for each taxable year, a tax equal to the excess, if any, of—

(1) The tentative minimum tax for the taxable year, over

(2) The regular tax for the taxable year.

(b) For purposes of this chapter, each of the following shall apply:

(1) The tentative minimum tax shall be computed in accordance with Sections 55 to 59, inclusive, of the Internal Revenue Code, except as otherwise provided in this part.

(2) The regular tax shall be the amount of tax imposed by Section 17041 or 17048, before reduction for any credits against the tax, less any amount imposed under paragraph (1) of subdivision (d) and paragraph (1) of subdivision (e) of Section 17560.

(3) (A) The provisions of Section 55(b)(1) of the Internal Revenue Code shall be modified to provide that the tentative minimum tax for the taxable year shall be equal to the following percent of so much of the alternative minimum taxable income for

1 the taxable year as exceeds the exemption amount, before
2 reduction for any credits against the tax:

3 (i) For any taxable year beginning on or after January 1, 1991,
4 and before January 1, 1996, 8.5 percent.

5 (ii) For any taxable year beginning on or after January 1, 1996,
6 7 percent.

7 (B) In the case of a nonresident or part-year resident, the
8 tentative minimum tax shall be computed by multiplying the
9 alternative minimum taxable income of the nonresident or
10 part-year resident, as defined in subparagraph (C), by a rate
11 (expressed as a percentage) equal to the tax computed under
12 subdivision (b) on the alternative minimum taxable income of the
13 nonresident or part-year resident as if the nonresident or part-year
14 resident were a resident of this state for the taxable year and as if
15 the nonresident or part-year resident were a resident of this state
16 for all prior taxable years for any carryover items, deferred
17 income, suspended losses, or suspended deductions, divided by
18 the amount of that income.

19 (C) For purposes of this section, the term “alternative
20 minimum taxable income of a nonresident or part-year resident”
21 includes each of the following:

22 (i) For any period during which the taxpayer was a resident of
23 this state (as defined by Section 17014), all items of alternative
24 minimum taxable income (as modified for purposes of this
25 chapter), regardless of source.

26 (ii) For any period during which the taxpayer was not a resident
27 of this state, alternative minimum taxable income (as modified for
28 purposes of this chapter) which were derived from sources within
29 this state, determined in accordance with Article 9 of Chapter 3
30 (commencing with Section 17301) and Chapter 11 (commencing
31 with Section 17951).

32 (iii) For purposes of computing “alternative minimum taxable
33 income of a nonresident or part-year resident,” any carryover
34 items, deferred income, suspended losses, or suspended
35 deductions shall only be allowable to the extent that the carryover
36 item, suspended loss, or suspended deduction was derived from
37 sources within this state.

38 (4) The provisions of Section 55(b)(2) of the Internal Revenue
39 Code, relating to alternative minimum taxable income, shall be
40 modified to provide that alternative minimum taxable income

1 shall not include the income, adjustments, and items of tax
2 preference attributable to any trade or business of a qualified
3 taxpayer.

4 (A) For purposes of this paragraph, “qualified taxpayer”
5 means a taxpayer who meets both of the following:

6 (i) Is the owner of, or has an ownership interest in, a trade or
7 business.

8 (ii) Has aggregate gross receipts, less returns and allowances,
9 of less than one million dollars (\$1,000,000) during the taxable
10 year from all trades or businesses of which the taxpayer is the
11 owner or has an ownership interest, in the amount of that
12 taxpayer’s proportionate interest in each trade or business.

13 (B) For purposes of this paragraph, “aggregate gross receipts,
14 less returns and allowances” means the sum of the gross receipts
15 of the trades or businesses which the taxpayer owns and the
16 proportionate interest of the gross receipts of the trades or
17 businesses which the taxpayer owns and of pass-through entities
18 in which the taxpayer holds an interest.

19 (C) For purposes of this paragraph, “gross receipts, less returns
20 and allowances” means the sum of the gross receipts from the
21 production of business income, as defined in subdivision (a) of
22 Section 25120, and the gross receipts from the production of
23 nonbusiness income, as defined in subdivision (d) of Section
24 25120.

25 (D) For purposes of this paragraph, “proportionate interest”
26 means:

27 (i) In the case of a pass-through entity which reports a profit for
28 the taxable year, the taxpayer’s profit interest in the entity at the
29 end of the taxpayer’s taxable year.

30 (ii) In the case of a pass-through entity which reports a loss for
31 the taxable year, the taxpayer’s loss interest in the entity at the end
32 of the taxpayer’s taxable year.

33 (iii) In the case of a pass-through entity which is sold or
34 liquidates during the taxable year, the taxpayer’s capital account
35 interest in the entity at the time of the sale or liquidation.

36 (E) (i) For purposes of this paragraph, “proportionate
37 interest” includes an interest in a pass-through entity.

38 (ii) For purposes of this paragraph, “pass-through entity”
39 means any of the following:

40 (I) A partnership, as defined by Section 17008.

1 (II) An S corporation, as provided in Chapter 4.5 (commencing
2 with Section 23800) of Part 11.

3 (III) A regulated investment company, as provided in Section
4 24871.

5 (IV) A real estate investment trust, as provided in Section
6 24872.

7 (V) A real estate mortgage investment conduit, as provided in
8 Section 24874.

9 (5) For taxable years beginning on or after January 1, 1998,
10 Section 55(d)(1) of the Internal Revenue Code, relating to
11 exemption amount for taxpayers other than corporations is
12 modified, for purposes of this part, to provide the following
13 exemption amounts in lieu of those contained therein:

14 (A) Fifty-seven thousand two hundred sixty dollars (\$57,260)
15 in the case of either of the following:

16 (i) A joint return.

17 (ii) A surviving spouse.

18 (B) Forty-two thousand nine hundred forty-five dollars
19 (\$42,945) in the case of an individual who is both of the following:

20 (i) Not a married individual.

21 (ii) Not a surviving spouse.

22 (C) Twenty-eight thousand six hundred thirty dollars
23 (\$28,630) in the case of either of the following:

24 (i) A married individual who files a separate return.

25 (ii) An estate or trust.

26 (6) For taxable years beginning on or after January 1, 1998,
27 Section 55(d)(3) of the Internal Revenue Code, relating to the
28 phaseout of exemption amount for taxpayers other than
29 corporations is modified, for purposes of this part, to provide the
30 following phaseout of exemption amounts in lieu of those
31 contained therein:

32 (A) Two hundred fourteen thousand seven hundred
33 twenty-five dollars (\$214,725) in the case of a taxpayer described
34 in subparagraph (A) of paragraph (5).

35 (B) One hundred sixty-one thousand forty-four dollars
36 (\$161,044) in the case of a taxpayer described in subparagraph (B)
37 of paragraph (5).

38 (C) One hundred seven thousand three hundred sixty-two
39 dollars (\$107,362) in the case of a taxpayer described in
40 subparagraph (C) of paragraph (5).

(7) For each taxable year beginning on or after January 1, 1999, the Franchise Tax Board shall recompute the exemption amounts prescribed in paragraph (5) and the phaseout of exemption amounts prescribed in paragraph (6). Those computations shall be made as follows:

(A) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(B) The Franchise Tax Board shall do both of the following:

(i) Compute an inflation adjustment factor by adding 100 percent to the percentage change figure that is furnished pursuant to subparagraph (A) and dividing the result by 100.

(ii) Multiply the preceding taxable year exemption amounts and the phaseout of exemption amounts by the inflation adjustment factor determined in clause (i) and round off the resulting products to the nearest one dollar (\$1).

(c) (1) (A) Section 56(a)(6) of the Internal Revenue Code as in effect on January 1, 1997, relating to installment sales of certain property, shall not apply to payments received in taxable years beginning on or after January 1, 1997, with respect to dispositions occurring in taxable years beginning after December 31, 1987.

(B) This paragraph shall not apply to taxable years beginning on or after January 1, 1998.

(2) Section 56(b)(1)(E) of the Internal Revenue Code, relating to standard deduction and deduction for personal exemptions not allowed, is modified, for purposes of this part, to deny the standard deduction allowed by Section 17073.5.

(3) Section 56(b)(3) of the Internal Revenue Code, relating to treatment of incentive stock options, shall be modified to additionally provide the following:

(A) Section 421 of the Internal Revenue Code shall not apply to the transfer of stock acquired pursuant to the exercise of a California qualified stock option under Section 17502.

(B) Section 422(c)(2) of the Internal Revenue Code shall apply in any case where the disposition and inclusion of a California qualified stock option for purposes of this chapter are within the same taxable year and that section shall not apply in any other case.

1 (C) The adjusted basis of any stock acquired by the exercise of
2 a California qualified stock option shall be determined on the basis
3 of the treatment prescribed by this paragraph.

4 (d) The provisions of Section 57(a)(5) of the Internal Revenue
5 Code, relating to tax-exempt interest shall not apply.

6 (e) Section 57(a) of the Internal Revenue Code, relating to
7 items of tax preference, is modified to include as an item of tax
8 preference an amount equal to one-half of the amount excluded
9 from gross income for the taxable year under Section 18152.5.

10 (f) The provisions of Section 59(a) of the Internal Revenue
11 Code, relating to the alternative minimum tax foreign tax credit,
12 shall not apply.

13 *SEC. 4. Section 17063 of the Revenue and Taxation Code is*
14 *amended to read:*

15 17063. (a) There shall be allowed as a credit against the net
16 tax (as defined by Section 17039) for any taxable year an amount
17 equal to the minimum tax credit for that taxable year.

18 (b) For purposes of subdivision (a), the minimum tax credit
19 shall be determined in accordance with Section 53 of the Internal
20 Revenue Code, except as otherwise provided in this part.

21 (c) For purposes of this chapter, the amount determined under
22 Section 53(c)(1) of the Internal Revenue Code shall be the regular
23 tax as defined by paragraph (2) of subdivision (b) of Section
24 17062, reduced by the sum of the credits allowable under this part,
25 other than:

26 (1) The credits described in paragraph (7) of subdivision (a) of
27 Section 17039.

28 (2) Any credit which reduces the tax below the tentative
29 minimum tax, as defined by Section 17062.

30 (d) Section 53(d)(1)(B)(ii)(II) of the Internal Revenue Code,
31 relating to credit not allowed for exclusion preferences, is
32 modified to include subdivision (e) of Section 17062, as a
33 specified item.

34 *SEC. 5. Section 17073 of the Revenue and Taxation Code is*
35 *amended to read:*

36 17073. (a) Section 63 of the Internal Revenue Code, relating
37 to taxable income defined, shall apply, except as otherwise
38 provided.

(b) Notwithstanding subdivision (e) of Section 17024.5, an individual may make a separate state election to itemize deductions under Section 63(e) of the Internal Revenue Code.

(c) The deduction allowed by Section 17208.1, relating to interest on loans or financed indebtedness obtained from a publicly owned utility for the purchase and installation of energy efficient products or equipment, shall not be treated as a miscellaneous itemized deduction under Section 67(a) of the Internal Revenue Code, relating to the 2-percent floor on miscellaneous deductions.

(d) For individuals who do not itemize deductions, the standard deduction computed in accordance with Section 17073.5 shall be allowed as a deduction in computing taxable income.

SEC. 6. Section 17085 of the Revenue and Taxation Code is amended to read:

17085. Section 72 of the Internal Revenue Code, as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), relating to annuities and certain proceeds of life insurance contracts, is modified as follows:

(a) The amendments and transitional rules made by Public Law 99-514 shall be applicable to this part for the same transactions and the same years as they are applicable for federal income tax purposes, except that the repeal of Section 72(d) of the Internal Revenue Code, relating to repeal of special rule for employees' annuities, shall apply only to the following:

(1) Any individual whose annuity starting date is after December 31, 1986.

(2) At the election of the taxpayer, any individual whose annuity starting date is after July 1, 1986, and before January 1, 1987.

(b) The amount of a distribution from an individual retirement account or annuity or employees' trust or employee annuity that is includable in gross income for federal income tax purposes shall be reduced for purposes of this part by the lesser of either of the following:

(1) An amount equal to the amount includable in federal gross income for the taxable year.

(2) An amount equal to the basis in the account or annuity allowed by Section 17507 (relating to individual retirement accounts and simplified employee pensions) or the increased basis allowed by Sections 17504 and 17506 (relating to plans of

1 self-employed individuals), the increased basis allowed by
2 Section 17501, or the increased basis allowed by Section 17551
3 that is remaining after adjustment for reductions in gross income
4 under this provision in prior taxable years.

5 (c) (1) Except as provided in paragraph (2), the amount of the
6 penalty imposed under this part shall be computed in accordance
7 with Sections 72(m), (q), (t), and (v) of the Internal Revenue Code
8 using a rate of $2\frac{1}{2}$ percent, in lieu of the rate provided in those
9 sections.

10 (2) In the case where Section 72(t)(6) of the Internal Revenue
11 Code, relating to special rules for simple retirement accounts,
12 applies, the rate in paragraph (1) shall be 6 percent in lieu of the
13 $2\frac{1}{2}$ percent rate specified therein.

14 (d) Section 72(f)(2) of the Internal Revenue Code, relating to
15 special rules for computing employees' contributions, shall be
16 applicable without applying the exceptions which immediately
17 follow that paragraph.

18 *SEC. 7. Section 17140 of the Revenue and Taxation Code is*
19 *amended to read:*

20 17140. (a) For purposes of this section, the following terms
21 have the following meanings as provided in the Golden State
22 Scholarshare Trust Act (Article 19 (commencing with Section
23 69980) of Chapter 2 of Part 42 of the Education Code):

24 (1) "Beneficiary" has the meaning set forth in subdivision (c)
25 of Section 69980 of the Education Code.

26 (2) "Benefit" has the meaning set forth in subdivision (d) of
27 Section 69980 of the Education Code.

28 (3) "Participant" has the meaning set forth in subdivision (h)
29 of Section 69980 of the Education Code.

30 (4) "Participation agreement" has the meaning set forth in
31 subdivision (i) of Section 69980 of the Education Code.

32 (5) "Scholarshare trust" has the meaning set forth in
33 subdivision (f) of Section 69980 of the Education Code.

34 (b) Except as otherwise provided in subdivision (c), gross
35 income of a beneficiary or a participant does not include any of the
36 following:

37 (1) Any distribution or earnings under a Scholarshare trust
38 participation agreement, as provided in Article 19 (commencing
39 with Section 69980) of Chapter 2 of Part 42 of the Education Code.

(2) Any contribution to the Scholarshare trust on behalf of a beneficiary shall not be includable as gross income of that beneficiary.

(c) (1) Any distribution under a Scholarshare trust participation agreement shall be includable in the gross income of the distributee in the manner as provided under Section 72 of the Internal Revenue Code, as modified by Section 17085, to the extent not excluded from gross income under this part. For purposes of applying Section 72 of the Internal Revenue Code, the following apply:

(A) All Scholarshare trust accounts of which an individual is a beneficiary shall be treated as one account, except as otherwise provided.

(B) All distributions during a taxable year shall be treated as one distribution.

(C) The value of the participation agreement, income on the participation agreement, and investment in the participation agreement shall be computed as of the close of the calendar year in which the taxable year begins.

(2) A contribution by a for-profit or nonprofit entity, or by a state or local government agency, for the benefit of an owner or employee of that entity or a beneficiary whom the owner or employee has the power to designate, including the owner or employee's minor children, shall be included in the gross income of that owner or employee in the year the contribution is made.

(3) For purposes of this subdivision, "distribution" includes any benefit furnished to a beneficiary under a participation agreement, as provided in Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code.

(4) (A) Paragraph (1) shall not apply to that portion of any distribution that, within 60 days of distribution, is transferred to the credit of another beneficiary under the Scholarshare trust who is a "member of the family," as that term is used in Section 529(e)(2) of the Internal Revenue Code, as amended by Section 211 of the Taxpayer Relief Act of 1997(Public Law 105-34), of the former beneficiary of that Scholarshare trust.

(B) Any change in the beneficiary of an interest in the Scholarshare trust shall not be treated as a distribution for purposes of paragraph (1) if the new beneficiary is a "member of the family," as that term is used in Section 529(e)(2) of the Internal

1 Revenue Code, as amended by Section 211 of the Taxpayer Relief
2 Act of 1997 (Public Law 105-34), of the former beneficiary of that
3 Scholarshare trust.

4 (d) For taxable years beginning on or after January 1, 2002,
5 Sections 529(c) and 529(e) of the Internal Revenue Code, as
6 amended by Section 402 of the Economic Growth and Tax Relief
7 Reconciliation Act of 2001 (Public Law 107-16), and Section 417
8 of the Job Creation and Worker Assistance Act of 2002 (Public
9 Law 107-147), shall apply in lieu of subdivisions (b) and (c) of this
10 section.

11 *SEC. 8. Section 17140.3 of the Revenue and Taxation Code is*
12 *amended to read:*

13 17140.3. Section 529 of the Internal Revenue Code, as
14 amended by Section 402 of the Economic Growth and Tax Relief
15 Reconciliation Act of 2001 (Public Law 107-16), and Section 417
16 of the Job Creation and Worker Assistance Act of 2002 (Public
17 Law 107-147), relating to qualified state tuition programs, shall
18 apply, except as otherwise provided.

19 (a) Section 529 (a) of the Internal Revenue Code is modified as
20 follows:

21 (1) By substituting the phrase “under this part and Part 11
22 (commencing with Section 23001)” in lieu of the phrase “under
23 this subtitle.”

24 (2) By substituting “Article 2 (commencing with Section
25 23731)” in lieu of “Section 511.”

26 (b) A copy of the report required to be filed with the Secretary
27 of the Treasury under Section 529(d) of the Internal Revenue Code
28 shall be filed with the Franchise Tax Board at the same time and
29 in the same manner as specified in that section.

30 *SEC. 9. Section 17144 of the Revenue and Taxation Code is*
31 *amended to read:*

32 17144. (a) Section 108(b)(2)(B) of the Internal Revenue
33 Code, relating to general business credit, is modified by
34 substituting “this part” in lieu of “Section 38 (relating to general
35 business credit).”

36 (b) Section 108(b)(2)(G) of the Internal Revenue Code,
37 relating to foreign tax credit carryovers, shall not apply.

38 (c) Section 108(b)(3)(B) of the Internal Revenue Code,
39 relating to credit carryover reduction, is modified by substituting
40 “11.1 cents” in lieu of “33¹/₃ cents” in each place in which it

appears. In the case where more than one credit is allowable under this part, the credits shall be reduced on a pro rata basis.

(d) Section 108(g)(3)(B) of the Internal Revenue Code, relating to adjusted tax attributes, is modified by substituting “(\$9)” in lieu of “(\$3).”

(e) (1) If a taxpayer makes an election for federal income tax purposes under Section 108(c) of the Internal Revenue Code, relating to treatment of discharge of qualified real property business indebtedness, a separate election shall not be allowed and the federal election shall be binding for purposes of this part.

(2) If a taxpayer has not made an election for federal income tax purposes under Section 108(c) of the Internal Revenue Code, relating to treatment of discharge of qualified real property business indebtedness, then the taxpayer shall not be allowed to make that election for purposes of this part.

SEC. 10. Section 17144.5 is added to the Revenue and Taxation Code, to read:

17144.5. Section 132 of the Internal Revenue Code, as amended by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), shall apply except as otherwise provided.

SEC. 11. Section 17152 of the Revenue and Taxation Code is amended to read:

17152. Section 121 of the Internal Revenue Code, relating to exclusion of gain from sale of principal residence, is modified as follows:

(a) The two-year period in Section 121(a) of the Internal Revenue Code shall be reduced by the period of the taxpayer’s service, not to exceed 18 months, in the Peace Corps during the five-year period ending on the date of the sale or exchange.

(b) If the taxpayer is prohibited from filing a joint return pursuant to Section 18521, Section 121(b)(2)(A) of the Internal Revenue Code shall nevertheless be treated as being satisfied if the taxpayer files a joint return for federal income tax purposes for the same taxable year. However, in no instance shall the total amount excludable from gross income under Section 121(a) of the Internal Revenue Code with respect to any sale or exchange exceed the maximum amount allowed by Section 121(b) of the Internal Revenue Code.

1 (c) (1) If a taxpayer has, at any time, made an election for
2 federal income tax purposes under Section 121(f) of the Internal
3 Revenue Code not to have Section 121 of the Internal Revenue
4 Code apply to a sale or exchange, Section 121 of the Internal
5 Revenue Code shall not apply to that sale or exchange for state
6 purposes, a separate election for state purposes shall not be
7 allowed and the federal election shall be binding for purposes of
8 this part, and that election shall be treated as an election to include
9 in gross income for purposes of this part all the gain from the sale
10 or exchange of that property, including that amount which, but for
11 that election, would have been excluded from income under
12 Section 121(a) of the Internal Revenue Code for state purposes.

13 (2) If a taxpayer fails to make an election for federal income tax
14 purposes under Section 121(f) of the Internal Revenue Code to not
15 have Section 121 of the Internal Revenue Code apply to a sale or
16 exchange, no election under Section 121(f) of the Internal
17 Revenue Code shall be allowed for state purposes, Section 121 of
18 the Internal Revenue Code shall apply to that sale or exchange for
19 state purposes, and a separate election for state purposes shall not
20 be allowed.

21 (d) (1) If a taxpayer has, at any time, made an election for
22 federal income tax purposes under Section 312(d)(2) of the
23 Taxpayer Relief Act of 1997 (Public Law 105-34), relating to sales
24 before date of enactment, or Section 312(d)(4) of that act, relating
25 to binding contracts, to not have the amendments made by Section
26 312 of the Taxpayer Relief Act of 1997 (Public Law 105-34) apply
27 to a sale or exchange, the amendments made by the act adding this
28 subdivision shall not apply to that sale or exchange, Sections 1, 4,
29 and 6 of Chapter 610 of the Statutes of 1997 shall not apply to that
30 sale or exchange, a separate election for state purposes shall not be
31 allowed and the federal election shall be binding for purposes of
32 this part.

33 (2) If a taxpayer fails to make an election for federal income tax
34 purposes under Section 312(d)(2) of the Taxpayer Relief Act of
35 1997 (Public Law 105-34), relating to sales before date of
36 enactment, or Section 312(d)(4) of that act, relating to binding
37 contracts, to not have the amendments made by Section 312 of the
38 Taxpayer Relief Act of 1997 (Public Law 105-34) apply to a sale
39 or exchange, an election under Section 312(d)(2) of the Taxpayer
40 Relief Act of 1997 (Public Law 105-34), relating to sales before



date of enactment, or Section 312(d)(4) of that act, relating to binding contracts, shall not be allowed for state purposes, the amendments made by the act adding this subdivision shall apply to that sale or exchange, Sections 1, 4, and 6 of Chapter 610 of the Statutes of 1997 shall apply to that sale or exchange, and a separate election for state purposes shall not be allowed.

SEC. 12. Section 17205 is added to the Revenue and Taxation Code, to read:

17205. Section 219 of the Internal Revenue Code, as amended by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), relating to retirement savings, shall apply, except as otherwise provided.

SEC. 13. Section 17207.5 is added to the Revenue and Taxation Code, to read:

17207.5. Notwithstanding subdivision (e) of Section 17024.5, a taxpayer may make a separate state election, under Section 165(i)(1) of the Internal Revenue Code, to take a loss attributable to a disaster into account in the taxable year immediately preceding the taxable year in which the disaster occurred.

SEC. 14. Section 17279 of the Revenue and Taxation Code is amended to read:

17279. Section 197 of the Internal Revenue Code, relating to amortization of goodwill and certain other intangibles, is modified as follows:

(a) (1) Section 13261(g) of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to effective dates, shall apply, except as otherwise provided.

(2) (A) If a taxpayer has, at any time, made an election for federal income tax purposes under Section 13261(g)(2) of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to election to have amendments apply to property acquired after July 25, 1991, or Section 13261(g)(3) of that act, relating to elective binding contract exception, a separate election for state purposes shall not be allowed and the federal election shall be binding for purposes of this part.

(B) If a taxpayer has not made an election for federal income tax purposes under Section 13261(g)(2) of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to election to have amendments apply to property acquired after July 25, 1991, or Section 13261(g)(3) of that act, relating to elective

1 binding contract exception, with respect to property acquired
2 before August 11, 1993, then the taxpayer shall not be allowed to
3 make an election under Section 13261(g) of the Revenue
4 Reconciliation Act of 1993 (Public Law 103-66), for purposes of
5 this part, with respect to that property.

6 (b) Notwithstanding any other provision of this section, each of
7 the following shall apply:

8 (1) No deduction shall be allowed under this section for any
9 taxable year beginning prior to January 1, 1994.

10 (2) No inference is intended with respect to the allowance or
11 denial of any deduction for amortization in any taxable year
12 beginning before January 1, 1994.

13 (3) In the case of an intangible that was acquired in a taxable
14 year beginning before January 1, 1994, the amount to be amortized
15 shall not exceed the adjusted basis of that intangible as of the first
16 day of the first taxable year beginning on or after January 1, 1994,
17 and that amount shall be amortized ratably over the period
18 beginning with the first month of the first taxable year beginning
19 on or after January 1, 1994, and ending 15 years after the month
20 in which the intangible was acquired.

21 *SEC. 15. Section 17279.4 of the Revenue and Taxation Code*
22 *is amended to read:*

23 17279.4. Section 198 of the Internal Revenue Code, relating
24 to expensing of environmental remediation costs, is modified as
25 follows:

26 (a) (1) If a taxpayer has, at any time, made an election for
27 federal income tax purposes under Section 198(a) of the Internal
28 Revenue Code to have Section 198 of the Internal Revenue Code
29 apply to a qualified environmental remediation expenditure,
30 Section 198 of the Internal Revenue Code shall apply to that
31 qualified environmental remediation expenditure for state
32 purposes, a separate election for state purposes shall not be
33 allowed and the federal election shall be binding for purposes of
34 this part.

35 (2) If a taxpayer fails to make an election for federal income tax
36 purposes under Section 198(a) of the Internal Revenue Code to
37 have Section 198 of the Internal Revenue Code apply to a qualified
38 environmental remediation expenditure, an election under Section
39 198(a) of the Internal Revenue Code shall not be allowed for state
40 purposes, Section 198 of the Internal Revenue Code shall not apply

1 to that qualified environmental remediation expenditure for state
2 purposes, and a separate election for state purposes shall not be
3 allowed.

4 (b) No inference as to the proper treatment for purposes of this
5 part of qualified environmental remediation expenditures for
6 periods before the enactment of this section shall be made.

7 *SEC. 16. Section 17501 of the Revenue and Taxation Code is*
8 *amended to read:*

9 17501. (a) Subchapter D of Chapter 1 of Subtitle A of the
10 Internal Revenue Code, relating to deferred compensation, shall
11 apply, except as otherwise provided.

12 (b) Notwithstanding Section 17024.5, Part I of Subchapter D
13 of Chapter 1 of Subtitle A of the Internal Revenue Code, relating
14 to pension, profit sharing, stock bonus plans, etc., shall apply,
15 except as otherwise provided, without regard to taxable year to the
16 same extent as applicable for federal purposes.

17 (c) The maximum amount of elective deferrals (as defined in
18 Section 402(g)(3)) for the taxable year that may be excluded from
19 gross income under Section 403(g) of the Internal Revenue Code,
20 as applicable for state purposes, shall not exceed the amount of
21 elective deferrals that may be excluded from gross income under
22 Section 402(g) of the Internal Revenue Code, as amended by Title
23 VI of the Economic Growth and Tax Relief Reconciliation Act of
24 2001 (Public Law 107-16) and Section 417 of the Job Creation and
25 Worker Assistance Act of 2002 (Public Law 107-147), including
26 additional elective deferrals under Section 414(v) of the Internal
27 Revenue Code, as added by Title VI of the Economic Growth and
28 Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and
29 Section 417 of the Job Creation and Worker Assistance Act of
30 2002 (Public Law 107-147).

31 (d) (1) For taxable years beginning on or after January 1, 2002,
32 the basis of any person in the plan, account, or annuity shall be
33 increased by the amount of elective deferrals not excluded as a
34 result of the application of subdivision (c).

35 (2) Any basis described in paragraph (1) shall be recovered in
36 the manner specified in Section 17085.

37 (e) Notwithstanding the limitations provided in subdivision
38 (c), any income attributable to elective deferrals in taxable years
39 beginning on or after January 1, 2002, in conformance with Part
40 I of Subchapter D of Chapter 1 of Subtitle A of the Internal

1 Revenue Code, as applicable for federal and state purposes, shall
2 not be includible in the gross income of the individual for whose
3 benefit the plan or account was established until distributed
4 pursuant to the provisions of the plan or by operation of law.

5 *SEC. 17. Section 17551 of the Revenue and Taxation Code is*
6 *amended to read:*

7 17551. (a) Subchapter E of Chapter 1 of Subtitle A of the
8 Internal Revenue Code, relating to accounting periods and
9 methods of accounting, shall apply, except as otherwise provided.

10 (b) Section 444(c)(1) of the Internal Revenue Code, relating to
11 effect of election, shall not apply.

12 (c) (1) Notwithstanding Section 17024.5, Section 457 of the
13 Internal Revenue Code, relating to deferred compensation plans of
14 state and local governments and tax-exempt organizations, shall
15 apply, except as otherwise provided, without regard to taxable year
16 to the same extent as applicable for federal purposes.

17 (2) The maximum deferred compensation for the taxable year
18 that may be excluded from gross income under Section 457 of the
19 Internal Revenue Code shall not exceed the amount of deferred
20 compensation that may be excluded from gross income under
21 Section 457 of the Internal Revenue Code, as amended by Title VI
22 of the Economic Growth and Tax Relief Reconciliation Act of
23 2001 (Public Law 107-16) and Section 417 of the Job Creation and
24 Worker Assistance Act of 2002 (Public Law 107-147), including
25 additional elective deferrals under Section 414(v) of the Internal
26 Revenue Code, as added by Title VI of the Economic Growth and
27 Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and
28 Section 417 of the Job Creation and Workers Assistance Act of
29 2002 (Public Law 107-147).

30 (d) (1) For taxable years beginning on or after January 1, 2002,
31 the basis of any person in the plan shall be increased by the amount
32 of compensation not allowed to be excluded under subdivision (a).

33 (2) Any basis described in paragraph (1) shall be recovered in
34 the manner specified in Section 17085.

35 (e) Notwithstanding the limitations provided in subdivision
36 (a), any income attributable to compensation deferred in a plan in
37 taxable years beginning on or after January 1, 2002, in
38 conformance with Section 457 of the Internal Revenue Code, as
39 applicable for federal and state purposes, shall not be includable
40 in the gross income of the individual for whose benefit the plan was

1 established until distributed pursuant to the provisions of the plan
2 or by operation of law.

3 *SEC. 18. Section 17570 of the Revenue and Taxation Code is*
4 *amended to read:*

5 17570. (a) For each taxable year beginning on or after
6 January 1, 1997, Section 475 of the Internal Revenue Code,
7 relating to mark to market accounting method for securities
8 dealers, shall apply, except as otherwise provided.

9 (b) Section 13233(c)(2)(C) of the Revenue Reconciliation Act
10 of 1993 (Public Law 103-66), relating to the effective date for
11 changes in the mark to market accounting method for securities
12 dealers, is modified to provide that the amount taken into account
13 under Section 481 of the Internal Revenue Code of 1986 shall be
14 taken into account ratably over the five-taxable-year period
15 beginning with the first taxable year beginning on or after January
16 1, 1997.

17 (c) (1) If a taxpayer has, at any time, made an election for
18 federal income tax purposes under Section 475(e) of the Internal
19 Revenue Code, relating to election of mark to market for dealers
20 in commodities, to have Section 475 of the Internal Revenue Code
21 apply, Section 475 of the Internal Revenue Code shall apply to that
22 dealer in commodities for state purposes, a separate election for
23 state purposes shall not be allowed and the federal election shall
24 be binding for purposes of this part.

25 (2) If a taxpayer fails to make, or has not previously made, an
26 election for federal income tax purposes under Section 475(e) of
27 the Internal Revenue Code, relating to election of mark to market
28 for dealers in commodities, to have Section 475 of the Internal
29 Revenue Code apply, an election under Section 475(e) of the
30 Internal Revenue Code shall not be allowed for state purposes,
31 Section 475 of the Internal Revenue Code shall not apply to that
32 dealer in commodities for state purposes, and a separate election
33 for state purposes shall not be allowed.

34 (d) (1) If a taxpayer has, at any time, made an election for
35 federal income tax purposes under Section 475(f)(1) of the
36 Internal Revenue Code, relating to election of mark to market for
37 traders in securities, to have Section 475 of the Internal Revenue
38 Code apply to a trade or business, Section 475 of the Internal
39 Revenue Code shall apply to that trader in securities for state
40 purposes with respect to that trade or business, a separate election

1 for state purposes with respect to that trade or business shall not be
2 allowed and the federal election shall be binding for purposes of
3 this part.

4 (2) If a taxpayer fails to make, or has not previously made, an
5 election for federal income tax purposes under Section 475(f)(1)
6 of the Internal Revenue Code, relating to election of mark to
7 market for traders in securities, to have Section 475 of the Internal
8 Revenue Code apply to a trade or business, an election under
9 Section 475(f)(1) of the Internal Revenue Code shall not be
10 allowed for state purposes with respect to that trade or business,
11 Section 475 of the Internal Revenue Code shall not apply to that
12 trader in securities for state purposes with respect to that trade or
13 business, and a separate election for state purposes shall not be
14 allowed.

15 (e) (1) If a taxpayer has, at any time, made an election for
16 federal income tax purposes under Section 475(f)(2) of the
17 Internal Revenue Code, relating to election of mark to market for
18 traders in commodities, to have Section 475 of the Internal
19 Revenue Code apply to a trade or business, Section 475 of the
20 Internal Revenue Code shall apply to that trader in commodities
21 for state purposes with respect to that trade or business, a separate
22 election for state purposes with respect to that trade or business
23 shall not be allowed and the federal election with respect to that
24 trade or business shall be binding for purposes of this part.

25 (2) If a taxpayer fails to make, or has not previously made, an
26 election for federal income tax purposes under Section 475(f)(2)
27 of the Internal Revenue Code, relating to election of mark to
28 market for traders in commodities, to have Section 475 of the
29 Internal Revenue Code apply to a trade or business, an election
30 under Section 475(f)(2) of the Internal Revenue Code shall not be
31 allowed for state purposes with respect to that trade or business,
32 Section 475 of the Internal Revenue Code shall not apply to that
33 trader in commodities for state purposes with respect to that trade
34 or business, and a separate election for state purposes with respect
35 to that trade or business shall not be allowed.

36 (f) (1) An election under Section 475(e) or (f) of the Internal
37 Revenue Code made for federal income tax purposes with respect
38 to a taxable year beginning before January 1, 1998, shall be treated
39 as having been made for state purposes with respect to the first
40 taxable year beginning on or after January 1, 1998.

(2) Section 1001(d)(4)(B) of the Taxpayer Relief Act of 1997 (Public Law 105-34), relating to the effective date for election of mark to market by securities traders and traders and dealers in commodities, is modified to provide that the requirement for timely identification shall be treated as timely made for state purposes if that identification is treated as timely made for federal income tax purposes, and the amount taken into account under Section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the four-taxable-year period beginning with the first taxable year beginning on or after January 1, 1998.

SEC. 19. Section 17751 of the Revenue and Taxation Code is amended to read:

17751. Section 646 of the Internal Revenue Code, relating to certain revocable trusts treated as part of estate, is modified as follows:

(a) An election under Section 646(a) of the Internal Revenue Code for federal income tax purposes shall be treated for purposes of this part as an election made by the executor, if any, of the estate and the trustee of the qualified revocable trust under Section 646(a) of the Internal Revenue Code for state purposes and a separate election shall not be allowed.

(b) If the executor, if any, of the estate and the trustee of a qualified revocable trust fail to make an election under Section 646(a) of the Internal Revenue Code for federal income tax purposes with respect to that qualified revocable trust, that trust shall be treated and taxed for purposes of this part as a separate trust, an election under Section 646(a) of the Internal Revenue Code for state purposes with respect to that trust shall not be allowed, and a separate election shall not be allowed with respect to that trust.

SEC. 20. Section 17752 of the Revenue and Taxation Code is amended to read:

17752. Section 663 of the Internal Revenue Code, relating to special rules applicable to Sections 661 and 662, is modified as follows:

(a) Section 663(b) of the Internal Revenue Code, relating to distributions in the first 65 days of the taxable year, is modified as follows:

(1) An election under Section 663(b) of the Internal Revenue Code for federal income tax purposes shall be treated for purposes

1 of this part as an election made by the executor of the estate or the
2 fiduciary of the trust, as the case may be, under Section 663(b) of
3 the Internal Revenue Code for state purposes and a separate
4 election shall not be allowed.

5 (2) If the executor of the estate or the fiduciary of the trust, as
6 the case may be, fails to make an election under Section 663(b) of
7 the Internal Revenue Code for federal income tax purposes with
8 respect to an amount properly paid or credited within 65 days of
9 the taxable year, that amount shall not be considered for purposes
10 of this part as having been paid or credited on the last day of the
11 preceding taxable year, an election under Section 663(b) of the
12 Internal Revenue Code for state purposes with respect to that
13 amount shall not be allowed, and a separate election shall not be
14 allowed with respect to that amount.

15 (b) Section 663(c) of the Internal Revenue Code, relating to
16 separate shares treated as separate estates or trusts, is modified as
17 follows:

18 (1) An election under Section 663(c) of the Internal Revenue
19 Code for federal income tax purposes shall be treated for purposes
20 of this part as an election made by the executor of the estate or the
21 fiduciary of the trust, as the case may be, under Section 663(c) of
22 the Internal Revenue Code for state purposes and a separate
23 election shall not be allowed.

24 (2) If the executor of the estate or the fiduciary of the trust, as
25 the case may be, fails to make an election under Section 663(c) of
26 the Internal Revenue Code for federal income tax purposes with
27 respect to separate shares treated as separate estates or trusts, an
28 election under Section 663(c) of the Internal Revenue Code for
29 state purposes shall not be allowed, and a separate election shall
30 not be allowed.

31 *SEC. 21. Section 17760.5 of the Revenue and Taxation Code*
32 *is amended to read:*

33 17760.5. Section 685 of the Internal Revenue Code, relating
34 to treatment of funeral trusts, is modified as follows:

35 (a) Section 685(a) of the Internal Revenue Code is modified to
36 read: In the case of a qualified funeral trust—

37 (1) Subparts B, C, D, and E of Subchapter J of Chapter 1 of
38 Subtitle A of the Internal Revenue Code shall not apply.

39 (2) No credit for personal exemption shall be allowed under
40 Section 17054 or Section 17733.

(b) Section 685(b) of the Internal Revenue Code is modified as follows:

(1) An election under Section 685(b)(5) of the Internal Revenue Code for federal income tax purposes shall be treated for purposes of this part as an election made by the trustee of the qualified funeral trust under Section 685(b)(5) of the Internal Revenue Code for state purposes and a separate election shall not be allowed.

(2) If the trustee of a qualified funeral trust fails to make an election under Section 685(b)(5) of the Internal Revenue Code for federal income tax purposes with respect to a qualified funeral trust, that trust shall be treated for purposes of this part as owned under Subpart E of the Internal Revenue Code by the purchasers of the contracts described in Section 685(b)(1) of the Internal Revenue Code, an election under Section 685(b)(5) of the Internal Revenue Code for state purposes with respect to that trust shall not be allowed, and a separate election shall not be allowed with respect to that trust.

(c) Section 685(d) of the Internal Revenue Code is modified to read: Subdivision (e) of Section 17041 shall be applied to each qualified funeral trust by treating each beneficiary's interest in each qualified funeral trust as a separate trust.

(d) The Franchise Tax Board may, by forms and instructions, provide rules for simplified reporting of all trusts having a single trustee consistent with the rules prescribed by the Secretary of the Treasury under Section 685 of the Internal Revenue Code.

(e) This section shall apply to taxable years ending after August 5, 1997.

(f) The amendments made to this section by the act adding this subdivision shall apply to taxable years beginning on or after January 1, 1998.

SEC. 21.2. Section 18037 of the Revenue and Taxation Code is repealed.

SEC. 21.4. Section 18521 of the Revenue and Taxation Code is amended to read:

18521. (a) (1) Except as otherwise provided in this section, an individual shall use the same filing status that he or she used on his or her federal income tax return filed for the same taxable year.

(2) If the Franchise Tax Board determines that the filing status used on the taxpayer's federal income tax return was incorrect, the

1 Franchise Tax Board may, under Section 19033 (relating to
2 deficiency assessments), revise the return to reflect a correct filing
3 status.

4 (3) If either spouse was a nonresident for any portion of the
5 taxable year, a husband and wife who file a joint federal income
6 tax return shall be required to file a joint nonresident return.

7 (b) In the case of an individual who is not required to file a
8 federal income tax return for the taxable year, that individual may
9 use any filing status on the return required under this part that he
10 or she would be eligible to use on a federal income tax return for
11 the same taxable year if a federal income tax return was required.

12 (c) Notwithstanding subdivision (a), a husband and wife may
13 file separate returns under this part if either spouse was either of
14 the following during the taxable year:

15 (1) An active member of the armed forces or any auxiliary
16 branch thereof.

17 (2) A nonresident for the entire taxable year who had no income
18 from a California source.

19 (d) Except for taxpayers described in subdivision (c), for any
20 taxable year with respect to which a joint return has been filed, a
21 separate return shall not be made by either spouse after the period
22 for either to file a separate return has expired.

23 (e) No joint return shall be made if the husband and wife have
24 different taxable years; except that if their taxable years begin on
25 the same day and end on different days because of the death of
26 either or both, then a joint return may be made with respect to the
27 taxable year of each. The above exception shall not apply if the
28 surviving spouse remarries before the close of his or her taxable
29 year, or if the taxable year of either spouse is a fractional part of
30 a year under Section 443(a) of the Internal Revenue Code.

31 (f) In the case of the death of one spouse or both spouses the
32 joint return with respect to the decedent may be made only by the
33 decedent's executor or administrator; except that, in the case of the
34 death of one spouse, the joint return may be made by the surviving
35 spouse with respect to both that spouse and the decedent if no
36 return for the taxable year has been made by the decedent, no
37 executor or administrator has been appointed, and no executor or
38 administrator is appointed before the last day prescribed by law for
39 filing the return of the surviving spouse. If an executor or
40 administrator of the decedent is appointed after the making of the

joint return by the surviving spouse and the executor disaffirms the joint return made for federal income tax purposes pursuant to Section 6013(a)(3) of the Internal Revenue Code, the executor or administrator shall be deemed to have disaffirmed the joint return made by the surviving spouse for purposes of Part 10 (commencing with Section 17001) and this part and shall make, within one year after the last day prescribed by law for filing the return of the surviving spouse, a separate return for the taxable year of the decedent with respect to which the joint return was made, in which case the return made by the survivor shall constitute his or her separate return. If an executor or administrator of the decedent is appointed after the making of the joint return by the surviving spouse and the executor does not disaffirm the joint return made for federal income tax purposes pursuant to Section 6013(a)(3) of the Internal Revenue Code, the executor or administrator shall not be allowed to disaffirm the joint return made by the surviving spouse for purposes of Part 10 (commencing with Section 17001) and this part.

SEC. 22. Section 19136 of the Revenue and Taxation Code is amended to read:

19136. (a) Section 6654 of the Internal Revenue Code, relating to failure by an individual to pay estimated income tax, shall apply, except as otherwise provided.

(b) Section 6654(a)(1) of the Internal Revenue Code is modified to refer to the rate determined under Section 19521 in lieu of Section 6621 of the Internal Revenue Code.

(c) (1) Section 6654(e)(1) of the Internal Revenue Code, relating to exceptions where the tax is a small amount, shall not apply.

(2) No addition to the tax shall be imposed under this section if the tax imposed under Section 17041 or 17048 for the preceding taxable year, minus the sum of any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, or the tax computed under Section 17041 or 17048 upon the estimated income for the taxable year, minus the sum of any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, is less than two hundred dollars (\$200), except in the case of a separate return filed by a married person the amount shall be less than one hundred dollars (\$100).

(d) Section 6654(f) of the Internal Revenue Code shall not apply and for purposes of this section the term “tax” means the tax imposed under Section 17041 or 17048, less any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, other than the credit provided by subdivision (a) of Section 19002.

(e) The credit for tax withheld on wages, as specified in Section 6654(g) of the Internal Revenue Code, shall be the credit allowed under subdivision (a) of Section 19002.

(f) This section shall apply to a nonresident individual.

SEC. 23. Section 19136.8 is added to the Revenue and Taxation Code, to read:

19136.8. (a) No addition to tax shall be made under Section 19136 for any period before April 15, 2003, with respect to any underpayment of an installment for the 2002 taxable year, to the extent that the underpayment was created or increased by any provision of the act adding this section.

(b) No addition of tax shall be made under Section 19142 for any period before April 15, 2003, with respect to any underpayment of an installment for the 2002 taxable year, to the extent that the underpayment was created or increased by any provision of the act adding this section.

(c) The Franchise Tax Board shall implement this section in a reasonable manner.

SEC. 24. Section 19365 of the Revenue and Taxation Code is amended to read:

19365. (a) (1) A corporation that is treated as an “S corporation” for a taxable year beginning in 2002 under Chapter 4.5 (commencing with Section 23800) of Part 11 may file an application for the transfer of an overpayment with respect to payments of estimated tax for taxable years beginning in 2002 to the personal income tax accounts of its shareholders. An application under this subdivision shall not constitute a claim for credit or refund.

(2) An application under this subdivision shall be verified in the manner prescribed by Section 18621 in the case of the taxpayer, and shall be filed in the manner and form prescribed by the Franchise Tax Board. The application shall set forth all of the following:

1 (A) The amount the “S corporation” estimates as its tax
2 liability under this part for the taxable year, which shall not be less
3 than the greater of 1¹/₂ percent of its net income or the applicable
4 minimum franchise tax.

5 (B) The amount and date of the estimated tax paid during the
6 taxable year.

7 (C) For each shareholder affected, his or her name, social
8 security account number, address, and percentage of ownership,
9 and any changes in that percentage of ownership for the S
10 corporation’s taxable year, the amount of each overpayment to be
11 transferred, and the date the amount was paid.

12 (D) Any other information for purposes of carrying out this
13 section as may be required by the Franchise Tax Board.

14 (b) (1) Within a period of 45 days from the date on which an
15 application for a transfer is filed under subdivision (a), the
16 Franchise Tax Board shall make, to the extent it deems practicable
17 in that period, a limited examination of the application to discover
18 omissions and errors therein, and shall determine the final amount
19 of the transfers upon the basis of the application and the
20 examination, except that the Franchise Tax Board may disallow,
21 without further action, any application which it finds contains
22 material omissions or errors which it deems cannot be corrected
23 within the 45-day period.

24 (2) The Franchise Tax Board, within the 45-day period referred
25 to in paragraph (1), may credit the amount of the overpayment
26 against any liability on the part of the taxpayer under Part 11
27 (commencing with Section 23001).

28 (3) In the event the amount available for transfer is less than
29 requested by the taxpayer, the overpayment amount shall be
30 allocated among the shareholders on a pro rata basis based on their
31 percentage of ownership stated on the application.

32 (4) For purposes of Part 10 (commencing with Section 17001),
33 Part 11 (commencing with Section 23001), and this part, the
34 transferred amounts shall be treated as if they had been estimated
35 tax payments paid by the respective shareholders on the date
36 originally paid by the corporation.

37 (5) No application under subdivision (a) shall be allowed
38 unless the amount to be transferred equals or exceeds five hundred
39 dollars (\$500).

(6) Each S corporation which files an application for transfer of overpayments under subdivision (a) shall furnish to each person who is a shareholder at any time during the taxable year a statement showing amounts and dates of the overpayments being transferred to that person's personal income tax account.

SEC. 25. *Section 23038.5 of the Revenue and Taxation Code is amended to read:*

23038.5. (a) Section 7704 of the Internal Revenue Code, relating to certain publicly traded partnerships treated as corporations, shall apply, except as otherwise provided.

(b) (1) Section 7704(a) of the Internal Revenue Code shall not apply to an electing 1987 partnership.

(2) For purposes of this subdivision, the term "electing 1987 partnership" means any publicly traded partnership if all of the following apply:

(A) The partnership is an existing partnership (as defined in Section 10211(c)(2) of the Revenue Reconciliation Act of 1987).

(B) Section 7704(a) of the Internal Revenue Code has not applied (and without regard to Section 7704(c)(1) of the Internal Revenue Code would not have applied) to that partnership for all prior taxable years beginning after December 31, 1987, and before January 1, 1998.

(C) (i) The partnership has made the election under Section 7704(g)(1)(C) of the Internal Revenue Code (as added by Public Law 105-34) for federal income tax purposes.

(ii) The election for federal income tax purposes described in clause (i) shall be treated as a binding election and a separate election for state tax purposes shall not be allowed.

(iii) The election for federal income tax purposes described in clause (i) shall be treated as a binding consent to the application of the tax imposed under paragraph (3) and a separate election for state tax purposes shall not be allowed.

(D) A partnership which, but for this subparagraph, would be treated as an electing 1987 partnership shall cease to be so treated (and the election under subparagraph (C) shall cease to be in effect) as of the first day after December 31, 1997, that the partnership is no longer treated as an electing 1987 partnership for federal tax purposes (and the election under Section 7704(g)(1)(C) of the Internal Revenue Code (as added by Public Law 105-34) ceases to be in effect for federal income tax purposes).

(3) (A) There is hereby imposed for each taxable year beginning on or after January 1, 1998, on the gross income of each electing 1987 partnership a tax equal to 1 percent of that partnership's gross income from all sources reportable to this state, taking into account Section 25101 and any election under Section 25110, attributable to the active conduct of trades and businesses by the partnership.

(B) The tax shall be due and payable on the date the return of the partnership is required to be filed under Section 18633, shall be collected and refunded in the same manner as other taxes imposed by this part, and shall be subject to interest and applicable penalties.

(C) For purposes of this paragraph, if a partnership is a partner in another partnership, the gross income referred to in subparagraph (A) shall include the partnership's distributive share of the gross income of the other partnership from all sources reportable to this state, taking into account Section 25101 and any election under Section 25110, attributable to the active conduct of trades and businesses of that other partnership. A similar rule shall apply in the case of lower-tiered partnerships.

(D) The tax imposed by this paragraph shall be treated as imposed by this part other than for purposes of determining the amount of any credit allowable under this part.

(4) The provisions of this subdivision shall apply to the taxable year for which the election described in clause (i) of subparagraph (C) of paragraph (2) is made for federal income tax purposes and all subsequent taxable years unless revoked by the partnership for federal income tax purposes. Any revocation made for federal income tax purposes shall be treated as a binding revocation under this part, but, once so revoked, may not be reinstated and a separate revocation for state purposes shall not be allowed.

(c) The amendment made to this section by the act adding this subdivision shall apply to taxable years beginning on or after January 1, 1998.

SEC. 26. Section 23051.5 of the Revenue and Taxation Code is amended to read:

23051.5. (a) (1) Unless otherwise specifically provided, the terms "Internal Revenue Code," "Internal Revenue Code of 1954," or "Internal Revenue Code of 1986," for purposes of this part, mean Title 26 of the United States Code, including all

1 amendments thereto, as enacted on the specified date for the
2 applicable taxable year as defined in paragraph (1) of subdivision
3 (a) of Section 17024.5.

4 (2) Unless otherwise specifically provided, for federal laws
5 enacted on or after January 1, 1987, and on or before the specified
6 date for the taxable year, uncodified provisions that relate to
7 provisions of the Internal Revenue Code that are incorporated for
8 purposes of this part, shall be applicable to the same taxable years
9 as the incorporated provisions.

10 (3) Subtitle G (Tax Technical Corrections) and Part I of Subtitle
11 H (Repeal of Expired or Obsolete Provisions) of the Revenue
12 Reconciliation Act of 1990 (Public Law 101-508) modified
13 numerous provisions of the Internal Revenue Code and provisions
14 of prior federal acts, some of which are incorporated by reference
15 into this part. Unless otherwise provided, the provisions described
16 in the preceding sentence, to the extent that they modify provisions
17 that are incorporated into this part, are declaratory of existing law
18 and shall be applied in the same manner and for the same periods
19 as specified in the Revenue Reconciliation Act of 1990.

20 (b) Unless otherwise specifically provided, when applying the
21 Internal Revenue Code for purposes of this part, a reference to any
22 of the following shall not be applicable for purposes of this part:

23 (1) Domestic International Sales Corporations (DISC), as
24 defined in Section 992(a) of the Internal Revenue Code.

25 (2) Foreign Sales Corporations (FSC), as defined in Section
26 922(a) of the Internal Revenue Code.

27 (3) A personal holding company, as defined in Section 542 of
28 the Internal Revenue Code.

29 (4) A foreign personal holding company, as defined in Section
30 552 of the Internal Revenue Code.

31 (5) A foreign investment company, as defined in Section
32 1246(b) of the Internal Revenue Code.

33 (6) A foreign trust as defined in Section 679 of the Internal
34 Revenue Code.

35 (7) Foreign income taxes and foreign income tax credits.

36 (8) Federal tax credits and carryovers of federal tax credits.

37 (c) (1) The provisions contained in Sections 41 to 44,
38 inclusive, and Section 172 of the Tax Reform Act of 1984 (Public
39 Law 98-369), relating to treatment of debt instruments, shall not
40 be applicable for taxable years beginning before January 1, 1987.

1 (2) The provisions contained in Public Law 99-121, relating to
2 the treatment of debt instruments, shall not be applicable for
3 taxable years beginning before January 1, 1987.

4 (3) For taxable years beginning on and after January 1, 1987,
5 the provisions referred to by paragraphs (1) and (2) shall be
6 applicable for purposes of this part in the same manner and with
7 respect to the same obligations as the federal provisions, except as
8 otherwise provided in this part.

9 (d) When applying the Internal Revenue Code for purposes of
10 this part, regulations promulgated in final form or issued as
11 temporary regulations by “the secretary” shall be applicable as
12 regulations issued under this part to the extent that they do not
13 conflict with this part or with regulations issued by the Franchise
14 Tax Board.

15 (e) Whenever this part allows a taxpayer to make an election on
16 or after January 1, 2002, in taxable years beginning on or after
17 January 1, 2002, the following rules shall apply:

18 (1) A proper election for federal income tax purposes filed with
19 the Internal Revenue Service in accordance with the Internal
20 Revenue Code or regulations issued by “the secretary” shall
21 treated as an election for purposes of this part and a separate
22 election for state purposes shall not be allowed.

23 (2) A copy of that election shall be furnished to the Franchise
24 Tax Board upon request.

25 (3) If the taxpayer does not make a proper election for federal
26 income tax purposes a separate election for purposes of this part
27 shall not be allowed, unless otherwise provided.

28 (f) Whenever this part allows or requires a taxpayer to file an
29 application or seek consent, the rules set forth in subdivision (e)
30 shall apply to that application or consent.

31 (g) When applying the Internal Revenue Code for purposes of
32 determining the statute of limitations under this part, any reference
33 to a period of three years shall be modified to read four years for
34 purposes of this part.

35 (h) When applying, for purposes of this part, any section of the
36 Internal Revenue Code or any applicable regulation thereunder, all
37 of the following shall apply:

38 (1) For purposes of Chapter 2 (commencing with Section
39 23101), Chapter 2.5 (commencing with Section 23400), and

1 Chapter 3 (commencing with Section 23501), the term “taxable
2 income” shall mean “net income.”

3 (2) For purposes of Article 2 (commencing with Section
4 23731) of Chapter 4, the term “taxable income” shall mean
5 “unrelated business taxable income,” as defined by Section
6 23732.

7 (3) Any reference to “subtitle,” “Chapter 1,” or “chapter”
8 shall mean this part.

9 (4) The provisions of Section 7806 of the Internal Revenue
10 Code, relating to construction of title, shall apply.

11 (5) Any provision of the Internal Revenue Code that becomes
12 operative on or after the specified date for that taxable year shall
13 become operative on the same date for purposes of this part.

14 (6) Any provision of the Internal Revenue Code that becomes
15 inoperative on or after the specified date for that taxable year shall
16 become inoperative on the same date for purposes of this part.

17 (7) Due account shall be made for differences in federal and
18 state terminology, effective dates, substitution of “Franchise Tax
19 Board” for “secretary” when appropriate, and other obvious
20 differences.

21 (8) Any provision of the Internal Revenue Code that refers to
22 a “corporation” shall, when applicable for purposes of this part,
23 include a “bank,” as defined by Section 23039.

24 (i) Any reference to a specific provision of the Internal
25 Revenue Code shall include modifications of that provision, if any,
26 in this part.

27 *SEC. 27. Section 23456 of the Revenue and Taxation Code is*
28 *amended to read:*

29 23456. For purposes of this part, Section 56 of the Internal
30 Revenue Code is modified as follows:

31 (a) (1) Section 56(a)(2) of the Internal Revenue Code, relating
32 to mining exploration and development costs, shall apply only to
33 expenses incurred during taxable years beginning on or after
34 January 1, 1988.

35 (2) Section 56(a)(5) of the Internal Revenue Code, relating to
36 pollution control facilities, shall apply only to amounts allowable
37 as a deduction under Section 24372.3.

38 (3) (A) Section 56(a)(6) of the Internal Revenue Code, as in
39 effect on January 1, 1997, relating to installment sales of certain
40 property, shall not apply to payments received in taxable years

beginning on or after January 1, 1997, with respect to dispositions occurring in taxable years beginning after December 31, 1987.

(B) This paragraph shall not apply to any taxable year beginning on or after January 1, 1998.

(b) For purposes of applying Section 56(d) of the Internal Revenue Code, all references to “December 31, 1986,” are modified to read “December 31, 1987,” and all references to “January 1, 1987,” are modified to read “January 1, 1988.”

(c) Section 56(d)(1) of the Internal Revenue Code, relating to the alternative tax net operating loss deduction, is modified to include the provisions of Section 25108.

(d) For each taxable year beginning on or after January 1, 1988, and before January 1, 1990, Section 56(f)(2)(E) of the Internal Revenue Code, as it read during that period, is modified to refer to both of the following:

(1) Cooperatives under Section 24404 in lieu of the deduction allowed under Section 1382(b) of the Internal Revenue Code.

(2) Credit unions under Section 24405 as though the deduction allowed under Section 1382(b) of the Internal Revenue Code applied to credit unions.

(e) Section 56(g) of the Internal Revenue Code, relating to adjustments based on adjusted current earnings, is modified to provide that for corporations whose income is determined under Chapter 17 (commencing with Section 25101), adjusted current earnings shall be allocated and apportioned in the same manner as net income is allocated and apportioned for purposes of the regular tax. In addition, each of the following shall apply:

(1) Sections 56(g)(1)(A) and 56(g)(3) of the Internal Revenue Code are modified to provide that the term “adjusted current earnings” means the sum of the adjusted current earnings of that corporation apportionable to this state and the adjusted current earnings allocable to this state.

(2) Section 56(g)(1)(B) of the Internal Revenue Code is modified to provide that the term “alternative minimum taxable income” means the sum of the alternative minimum taxable income of that corporation apportionable to this state and the alternative minimum taxable income allocable to this state.

(f) Section 56(g)(4)(A) of the Internal Revenue Code is modified to provide the following:

1 (1) In the case of any property placed in service on or after
2 January 1, 1981, and prior to January 1, 1987, other than
3 residential rental property for which an election was made under
4 former Section 24349.5, the amount allowable as depreciation or
5 amortization with respect to that property shall be the same amount
6 that would have been allowable for the taxable year had the
7 taxpayer depreciated the property under the straight line method
8 for each taxable year of the useful life (determined without regard
9 to Section 24354.2) for which the taxpayer has held the property.

10 (2) In the case of any property placed in service on or after
11 January 1, 1987, and prior to January 1, 1990, other than
12 residential rental property for which an election was made under
13 former Section 24349.5, the amount allowable as depreciation or
14 amortization with respect to that property shall be determined by
15 each of the following:

16 (A) Taking into account the adjusted basis of that property (as
17 determined for purposes of computing alternative minimum
18 taxable income) as of the close of the last taxable year beginning
19 before January 1, 1990.

20 (B) Using the straight-line method over the remainder of the
21 recovery period applicable to that property under the alternative
22 system of Section 168(g) of the Internal Revenue Code.

23 (3) The amendments made to paragraph (2) by the act adding
24 this paragraph shall apply to taxable years beginning on or after
25 January 1, 1990.

26 (4) The last sentence of Section 56(g)(4)(A)(i) of the Internal
27 Revenue Code, shall not apply to taxable years beginning before
28 January 1, 1998.

29 (g) (1) Section 56(g)(4)(C) of the Internal Revenue Code,
30 relating to disallowance of items not deductible in computing
31 earnings and profits, shall be modified as follows:

32 (A) (i) A deduction shall be allowed for amounts allowable as
33 a deduction for purposes of the regular tax under Sections 24402,
34 24410, 24411, and 25106.

35 (ii) For each taxable year beginning on or after January 1, 1990,
36 a deduction shall be allowed for amounts allowable as a deduction
37 to a credit union for purposes of the regular tax under Section
38 24405.



(B) Section 56(g)(4)(C)(ii) of the Internal Revenue Code, relating to special rule for 100-percent dividends, shall not be applicable.

(C) Section 56(g)(4)(C)(iii) of the Internal Revenue Code, relating to special rule for dividends from Section 936 companies, shall not be applicable.

(D) Section 56(g)(4)(C)(iv) of the Internal Revenue Code, relating to special rule for certain dividends received by certain cooperatives, shall not be applicable.

(2) Section 56(g)(4)(D)(ii) of the Internal Revenue Code is modified to specify that Sections 24364 and 24407 shall not apply to expenditures paid or incurred in taxable years beginning on or after January 1, 1990.

(3) With respect to corporations which are not subject to the tax imposed under Chapter 2 (commencing with Section 23101), the amount of interest income included in the adjusted current earnings shall not exceed the amount of interest income included for purposes of the regular tax.

(4) Appropriate adjustments shall be made to limit deductions from adjusted current earnings for interest expense in accordance with the provisions of Sections 24344 and 24425.

SEC. 28. Section 23457 of the Revenue and Taxation Code is amended to read:

23457. For purposes of this part, Section 57 of the Internal Revenue Code is modified as follows:

(a) Section 57(a)(5) of the Internal Revenue Code, relating to tax-exempt interest, shall not be applicable.

(b) Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference the amount by which the deduction allowable under Section 24348 for the taxable year for a reasonable addition to a reserve for bad debts exceeds the amount that would have been allowable had the taxpayer maintained its bad debt reserve for all taxable years on the basis of actual experience.

(c) Section 57(a)(6) of the Internal Revenue Code, relating to accelerated depreciation or amortization on certain property placed in service before January 1, 1987, is modified to read: With respect to each property as described in Section 1250(c) of the Internal Revenue Code as that provision read on April 1, 1970, the amount by which the deduction allowable for the taxable year for

1 exhaustion, wear, tear, obsolescence, or amortization exceeds the
2 depreciation deduction which would have been allowable for the
3 taxable year, had the taxpayer depreciated the property under the
4 straight-line method for each taxable year of its useful life
5 (determined without regard to Section 24354.2 or 24381) for
6 which the taxpayer has held the property.

7 *SEC. 28.2. Section 23609 of the Revenue and Taxation Code*
8 *is amended to read:*

9 23609. For each taxable year beginning on or after January 1,
10 1987, there shall be allowed as a credit against the “tax” (as
11 defined by Section 23036) an amount determined in accordance
12 with Section 41 of the Internal Revenue Code, except as follows:

13 (a) For each taxable year beginning before January 1, 1997,
14 both of the following modifications shall apply:

15 (1) The reference to “20 percent” in Section 41(a)(1) of the
16 Internal Revenue Code is modified to read “8 percent.”

17 (2) The reference to “20 percent” in Section 41(a)(2) of the
18 Internal Revenue Code is modified to read “12 percent.”

19 (b) (1) For each taxable year beginning on or after January 1,
20 1997, and before January 1, 1999, both of the following
21 modifications shall apply:

22 (A) The reference to “20 percent” in Section 41(a)(1) of the
23 Internal Revenue Code is modified to read “11 percent.”

24 (B) The reference to “20 percent” in Section 41(a)(2) of the
25 Internal Revenue Code is modified to read “24 percent.”

26 (2) For each taxable year beginning on or after January 1, 1999,
27 and before January 1, 2000, both of the following shall apply:

28 (A) The reference to “20 percent” in Section 41(a)(1) of the
29 Internal Revenue Code is modified to read “12 percent.”

30 (B) The reference to “20 percent” in Section 41(a)(2) of the
31 Internal Revenue Code is modified to read “24 percent.”

32 (3) For each taxable year beginning on or after January 1, 2000,
33 both of the following shall apply:

34 (A) The reference to “20 percent” in Section 41(a)(1) of the
35 Internal Revenue Code is modified to read “15 percent.”

36 (B) The reference to “20 percent” in Section 41(a)(2) of the
37 Internal Revenue Code is modified to read “24 percent.”

38 (c) (1) With respect to any expense paid or incurred after the
39 operative date of Section 6378, Section 41(b)(1) of the Internal
40 Revenue Code is modified to exclude from the definition of

1 “qualified research expense” any amount paid or incurred for
2 tangible personal property that is eligible for the exemption from
3 sales or use tax provided by Section 6378.

4 (2) “Qualified research” and “basic research” shall include
5 only research conducted in California.

6 (d) The provisions of Section 41(e)(7)(A) of the Internal
7 Revenue Code, shall be modified so that “basic research,” for
8 purposes of this section, includes any basic or applied research
9 including scientific inquiry or original investigation for the
10 advancement of scientific or engineering knowledge or the
11 improved effectiveness of commercial products, except that the
12 term does not include any of the following:

13 (1) Basic research conducted outside California.

14 (2) Basic research in the social sciences, arts, or humanities.

15 (3) Basic research for the purpose of improving a commercial
16 product if the improvements relate to style, taste, cosmetic, or
17 seasonal design factors.

18 (4) Any expenditure paid or incurred for the purpose of
19 ascertaining the existence, location, extent, or quality of any
20 deposit of ore or other mineral (including oil and gas).

21 (e) (1) In the case of a taxpayer engaged in any
22 biopharmaceutical research activities that are described in codes
23 2833 to 2836, inclusive, or any research activities that are
24 described in codes 3826, 3829, or 3841 to 3845, inclusive, of the
25 Standard Industrial Classification (SIC) Manual published by the
26 United States Office of Management and Budget, 1987 edition, or
27 any other biotechnology research and development activities, the
28 provisions of Section 41(e)(6) of the Internal Revenue Code shall
29 be modified to include both of the following:

30 (A) A qualified organization as described in Section
31 170(b)(1)(A)(iii) of the Internal Revenue Code and owned by an
32 institution of higher education as described in Section 3304(f) of
33 the Internal Revenue Code.

34 (B) A charitable research hospital owned by an organization
35 that is described in Section 501(c)(3) of the Internal Revenue
36 Code, is exempt from taxation under Section 501(a) of the Internal
37 Revenue Code, is not a private foundation, is designated a
38 “specialized laboratory cancer center,” and has received Clinical
39 Cancer Research Center status from the National Cancer Institute.

40 (2) For purposes of this subdivision:

(A) “Biopharmaceutical research activities” means those activities that use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities that make use of chemical compounds to produce commercial products.

(B) “Other biotechnology research and development activities” means research and development activities consisting of the application of recombinant DNA technology to produce commercial products, as well as research and development activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(f) In the case where the credit allowed by this section exceeds the “tax,” the excess may be carried over to reduce the “tax” in the following year, and succeeding years if necessary, until the credit has been exhausted.

(g) For each taxable year beginning on or after January 1, 1998, the reference to “Section 501(a)” in Section 41(b)(3)(C) of the Internal Revenue Code, relating to contract research expenses, is modified to read “this part or Part 10 (commencing with Section 17001).”

(h) (1) For each taxable year beginning on or after January 1, 1998, and before January 1, 2000:

(A) The reference to “1.65 percent” in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read “one and thirty-two hundredths of one percent.”

(B) The reference to “2.2 percent” in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read “one and seventy-six hundredths of one percent.”

(C) The reference to “2.75 percent” in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read “two and two-tenths of one percent.”

(2) For each taxable year beginning on or after January 1, 2000:

(A) The reference to “1.65 percent” in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read “one and forty-nine hundredths of one percent.”

1 (B) The reference to “2.2 percent” in Section 41(c)(4)(A)(ii)
2 of the Internal Revenue Code is modified to read “one and
3 ninety-eight hundredths of one percent.”

4 (C) The reference to “2.75 percent” in Section 41(c)(4)(A)(iii)
5 of the Internal Revenue Code is modified to read “two and
6 forty-eight hundredths of one percent.”

7 (3) Section 41(c)(6) of the Internal Revenue Code, relating to
8 gross receipts, is modified to take into account only those gross
9 receipts from the sale of property held primarily for sale to
10 customers in the ordinary course of the taxpayer’s trade or business
11 that is delivered or shipped to a purchaser within this state,
12 regardless of f.o.b. point or any other condition of the sale.

13 (i) Section 41(h) of the Internal Revenue Code, relating to
14 termination, shall not apply.

15 (j) Section 41(g) of the Internal Revenue Code, relating to
16 special rule for passthrough of credit, is modified by each of the
17 following:

18 (1) The last sentence shall not apply.

19 (2) If the amount determined under Section 41(a) of the
20 Internal Revenue Code for any taxable year exceeds the limitation
21 of Section 41(g) of the Internal Revenue Code, that amount may
22 be carried over to other taxable years under the rules of subdivision
23 (f), except that the limitation of Section 41(g) of the Internal
24 Revenue Code shall be taken into account in each subsequent
25 taxable year.

26 *SEC. 29. Section 23701s of the Revenue and Taxation Code is*
27 *amended to read:*

28 23701s. (a) An employee-funded pension trust described in
29 Section 501(c)(18) of the Internal Revenue Code, except as
30 otherwise provided.

31 (b) The last sentence in Section 501(c)(18) of the Internal
32 Revenue Code, as amended by Title VI of the Economic Growth
33 and Tax Relief Reconciliation Act of 2001 (Public Law 107-16),
34 relating to excess contributions under Section 4979, shall not
35 apply.

36 *SEC. 30. Section 23705 of the Revenue and Taxation Code is*
37 *amended to read:*

38 23705. (a) (1) An organization described in Section 23701i
39 (voluntary employee’s beneficiary associations) or 23701q
40 (qualified group legal service plans) which is part of a plan of an

1 employer shall not be exempt from tax under Section 23701,
2 unless that plan meets the requirements of Section 505(b) of the
3 Internal Revenue Code, as amended by Title VI of the Economic
4 Growth and Tax Relief Reconciliation Act of 2001 (Public Law
5 107-16).

6 (2) Paragraph (1) shall not apply to any organization described
7 in Section 505(a)(2) of the Internal Revenue Code.

8 (b) A copy of any notice filed with the Secretary of the
9 Treasury, pursuant to Section 505(c) of the Internal Revenue Code,
10 relating to application for tax-exempt status, shall be filed at the
11 same time and in the same manner with the Franchise Tax Board.

12 *SEC. 31. Section 23711 of the Revenue and Taxation Code is*
13 *amended to read:*

14 23711. Section 529 of the Internal Revenue Code, as amended
15 by Section 402 of the Economic Growth and Tax Relief
16 Reconciliation Act of 2001 (Public Law 107-16) and Section 417
17 of the Job Creation and Worker Assistance Act of 2002 (Public
18 Law 107-147) relating to qualified state tuition programs, shall
19 apply, except as otherwise provided.

20 (a) Section 529(a) of the Internal Revenue Code is modified as
21 follows:

22 (1) By substituting the phrase “under Part 10 (commencing
23 with Section 17001) and this part” in lieu of the phrase “under this
24 subtitle.”

25 (2) By substituting “Article 2 (commencing with Section
26 23731)” in lieu of “section 511.”

27 (b) A copy of the report required to be filed with the Secretary
28 of the Treasury under Section 529(d) of the Internal Revenue Code
29 shall be filed with the Franchise Tax Board at the same time and
30 in the same manner as specified in that section.

31 *SEC. 32. Section 23712 of the Revenue and Taxation Code is*
32 *amended to read:*

33 23712. Section 530 of the Internal Revenue Code, as amended
34 by Sections 401 and 402 of the Economic Growth and Tax Relief
35 Reconciliation Act of 2001 (Public Law 107-16) and Section 417
36 of the Job Creation and Worker Assistance Act of 2002 (Public
37 Law 107-147) relating to education individual retirement
38 accounts, shall apply, except as otherwise provided.

39 (a) Section 530(a) of the Internal Revenue Code is modified as
40 follows:

1 (1) By substituting the phrase “under Part 10 (commencing
2 with Section 17001) and this part” in lieu of the phrase “under this
3 subtitle.”

4 (2) By substituting “Article 2 (commencing with Section
5 23731)” in lieu of “section 511.”

6 (b) For taxable years beginning before January 1, 2002,
7 Section 530(b)(1) of the Internal Revenue Code, relating to the
8 definition of education individual retirement account, is modified
9 to additionally require that upon the date that the designated
10 beneficiary becomes 30 years of age, any balance to the credit of
11 the beneficiary shall be distributed within 30 days after the date the
12 beneficiary becomes 30 years of age to that beneficiary.

13 (c) Section 530(d) of the Internal Revenue Code is modified as
14 follows:

15 (1) By substituting the phrase “under Part 10 (commencing
16 with Section 17001) in the manner as provided in Section 72(b) of
17 the Internal Revenue Code, as modified by Part 10” in lieu of the
18 phrase “in the manner as provided in Section 72(b)” in Section
19 530(d)(1) of the Internal Revenue Code.

20 (2) (A) A taxpayer that has elected to waive the application of
21 Section 530(d)(2) of the Internal Revenue Code for federal income
22 tax purposes shall be treated as having waived the application of
23 that paragraph for state purposes, a separate election for state
24 purposes shall not be allowed under paragraph (3) of subdivision
25 (e) of Section 17024.5 or paragraph (3) of subdivision (e) of
26 Section 23051.5, and the federal election shall be binding for
27 purposes of Part 10 (commencing with Section 17001) and this
28 part.

29 (B) If a taxpayer fails to make an election under Section
30 530(d)(2)(C) of the Internal Revenue Code for federal income tax
31 purposes to waive the application of Section 530(d)(2) of the
32 Internal Revenue Code, an election under Section 530(d)(2)(C) of
33 the Internal Revenue Code shall not be allowed for state purposes,
34 Section 530(d)(2)(A) and (B) of the Internal Revenue Code shall
35 apply for state purposes, and a separate election for state purposes
36 shall not be allowed under paragraph (3) of subdivision (e) of
37 Section 17024.5.

38 (3) (A) By substituting the phrase “tax imposed by Part 10
39 (commencing with Section 17001)” in lieu of the phrase “tax

1 imposed by this chapter” in Section 530(d)(4)(A) of the Internal
2 Revenue Code.

3 (B) By substituting the phrase “increased by 2½ percent” in
4 lieu of the phrase “increased by 10 percent” in Section
5 530(d)(4)(A) of the Internal Revenue Code.

6 (C) By substituting the phrase “shall be included in the
7 contributor’s gross income under Part 10 (commencing with
8 Section 17001) or this part” in lieu of the phrase “shall be included
9 in gross income” in Section 530(d)(4)(C) of the Internal Revenue
10 Code.

11 (d) For purposes of Part 10 (commencing with Section 17001)
12 and this part, in the case of a custodial account treated as a trust by
13 reason of Section 530(g) of the Internal Revenue Code, the
14 custodian of that account shall be treated as the trustee thereof.

15 (e) A copy of the report, which is required to be filed with the
16 Secretary of the Treasury under Section 530(h) of the Internal
17 Revenue Code, shall be filed with the Franchise Tax Board at the
18 same time and in the same manner as specified in that section.

19 *SEC. 33. Section 23800.5 of the Revenue and Taxation Code*
20 *is amended to read:*

21 23800.5. (a) Section 1361(b)(2)(A) of the Internal Revenue
22 Code, relating to ineligible corporation defined, shall not apply
23 and in lieu thereof, for purposes of Section 1361(b)(1) of the
24 Internal Revenue Code, Part 10 (commencing with Section
25 17001), Part 10.2 (commencing with Section 18401), and this part,
26 “ineligible corporation” shall include a savings and loan
27 association, bank, or financial corporation which uses the reserve
28 method of accounting for bad debts described in Section 24348.

29 (b) Section 1361(b)(3) of the Internal Revenue Code, relating
30 to treatment of certain wholly owned subsidiaries, is modified as
31 follows:

32 (1) For purposes of Part 10 (commencing with Section 17001),
33 Part 10.2 (commencing with Section 18401), and this part:

34 (A) Section 1361(b)(3)(A)(i) of the Internal Revenue Code
35 shall apply, except as provided in subparagraph (B).

36 (B) There is hereby imposed a tax annually in an amount equal
37 to the applicable amount specified in paragraph (1) of subdivision
38 (d) of Section 23153 on a qualified Subchapter S subsidiary that
39 is incorporated under the laws of this state, qualified to transact
40 intrastate business in this state pursuant to Chapter 21

(commencing with Section 2100) of Division 1 of Title 1 of the Corporations Code, or doing business in this state.

(C) Every qualified Subchapter S subsidiary described in subparagraph (B) shall be subject to the tax imposed under subparagraph (B) from the earlier of the date of incorporation, qualification, or commencement of business in this state, until the effective date of dissolution or withdrawal as provided in Section 23331, or, if later, the date the corporation ceases to do business in this state.

(2) For purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part:

(A) Section 1361(b)(3)(A)(ii) of the Internal Revenue Code shall not apply and, in lieu thereof, subparagraph (B) shall apply and all references to Section 1361(b)(3)(A)(ii) of the Internal Revenue Code shall be treated as a reference to subparagraph (B).

(B) All activities, assets, liabilities, including liability for the tax imposed under this subdivision, and items of income, deduction, and credit of a qualified Subchapter S subsidiary shall be treated as activities (including activities for purposes of Section 23101), assets, liabilities, and those items, as the case may be, of the “S corporation.”

(3) Section 1361(b)(3)(B) of the Internal Revenue Code is modified to include the following requirements in addition to the requirements contained therein:

(A) The “S corporation” has in effect a valid election to treat the corporation as a qualified Subchapter S subsidiary for federal income tax purposes.

(B) An election made by the “S corporation” under Section 1361(b)(3)(B)(ii) of the Internal Revenue Code to treat the corporation as a qualified Subchapter S subsidiary for federal income tax purposes shall be treated for purposes of this part as an election made by the “S corporation” under this subdivision and a separate election shall not be allowed.

(C) No election under this subdivision shall be allowed unless the “S corporation” has made the election under Section 1361(b)(3)(B)(ii) of the Internal Revenue Code to treat the corporation as a qualified Subchapter S subsidiary for federal income tax purposes.

(c) Section 1361(c)(6) of the Internal Revenue Code, relating to certain exempt organizations permitted as shareholders, is

1 modified by substituting a reference to Section 17631 or Section
2 23701d in lieu of the reference to Section 501(c)(3) of the Internal
3 Revenue Code and by substituting a reference to Section 17631 or
4 Section 23701 in lieu of the reference to Section 501(a) of the
5 Internal Revenue Code.

6 (d) Section 1361(e)(1)(B)(ii) of the Internal Revenue Code,
7 relating to certain trusts not eligible, is modified by substituting
8 “under Part 10 (commencing with Section 17001) or this part” in
9 lieu of “under this subtitle.”

10 (e) Section 1361(e)(3) of the Internal Revenue Code, relating
11 to election, is modified to include the following provisions:

12 (1) An election made by the trustee under Section 1361(e) of
13 the Internal Revenue Code to be an electing small business trust for
14 federal income tax purposes shall be treated for purposes of this
15 part as an election made by the trustee under this subdivision and
16 a separate election shall not be allowed. Any election made shall
17 apply to the taxable year of the trust for which made and to all
18 subsequent taxable years of the trust, unless revoked with the
19 consent of the Franchise Tax Board.

20 (2) No election under this subdivision shall be allowed unless
21 the trustee has made the election under Section 1361(e) of the
22 Internal Revenue Code to be an electing small business trust for
23 federal income tax purposes.

24 *SEC. 34. Section 23801 of the Revenue and Taxation Code is*
25 *amended to read:*

26 23801. (a) Except as otherwise provided, a corporation that
27 has in effect for federal income tax purposes a valid election under
28 Section 1362(a) of the Internal Revenue Code shall be an “S
29 corporation” for purposes of Part 10 (commencing with Section
30 17001), Part 10.2 (commencing with Section 18401), and this part.

31 (b) A corporation that is an “S corporation” for federal income
32 tax purposes, shall be an “S corporation” for purposes of Part 10
33 (commencing with Section 17001), Part 10.2 (commencing with
34 Section 18401, and this part, and its shareholders shall be of an “S
35 corporation” without regard to whether the corporation is
36 qualified to do business or is incorporated in this state.

37 (c) Notwithstanding subdivision (a), a corporation that elects
38 “S corporation” status under Section 1362 of the Internal Revenue
39 Code for federal income tax purposes but which is not qualified to
40 be an “S corporation” under subdivision (a) of Section 23800.5,

shall not be an “S corporation” for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401, and this part.

(d) Except as provided in subdivision (e), a corporation is an “S corporation” for purposes of this part shall not be included in a combined report pursuant to Chapter 17 (commencing with Section 25101).

(e) (1) In cases where the Franchise Tax Board determines that the reported income or loss of a group of commonly owned or controlled corporations (within the meaning of Section 25105), which includes one or more corporations treated as an “S corporation” under Chapter 4.5 (commencing with Section 23800), does not clearly reflect income (or loss) of a member of that group or represents an evasion of tax by one or more members of that group, and the Franchise Tax Board determines that the comparable uncontrolled price method prescribed by regulations pursuant to Section 482 of the Internal Revenue Code cannot practically be applied, the Franchise Tax Board may, in lieu of other methods prescribed by regulations pursuant to Section 482 of the Internal Revenue Code, apply methods of unitary combination, pursuant to Article 1 (commencing with Section 25101) of Chapter 17, to properly reflect the income or loss of the members of the group.

(2) The application of the provisions of this subdivision shall not affect the treatment of any corporation as an “S corporation.”

(f) The tax for a “C corporation” for a short year shall be determined in accordance with Chapter 13 (commencing with Section 24631), in lieu of Section 1362(e)(5) of the Internal Revenue Code.

(g) (1) A termination of a federal election pursuant to Section 1362(d) of the Internal Revenue Code, that is not an inadvertent termination pursuant to Section 1362(f) of the Internal Revenue Code, shall simultaneously terminate the “S corporation” election for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part.

(2) A federal termination by revocation shall be effective for purposes of this part and shall be reported to the Franchise Tax Board in the form and manner prescribed by the Franchise Tax Board no later than the last date allowed for filing federal

1 termination for that year under Section 1362(d) of the Internal
2 Revenue Code.

3 (h) For taxable years beginning on or after January 1, 1997, for
4 purposes of subparagraph (F) of paragraph (4) of subdivision (a)
5 of this section and Section 1362(g) of the Internal Revenue Code,
6 relating to election after termination, any termination under
7 Section 1362(d) of the Internal Revenue Code or election to be
8 treated as a “C corporation” under subparagraph (A) or (C) of
9 paragraph (4) of subdivision (a), or to terminate by revocation
10 under paragraph (3) of subdivision (f) in a taxable year beginning
11 before January 1, 1997, shall not be taken into account.

12 (i) (1) The provisions of Section 1362(b)(5) of the Internal
13 Revenue Code, relating to authority to treat late elections, etc., as
14 timely, shall apply only for taxable years beginning on or after
15 January 1, 1997, with respect to elections under Section 1362(a)
16 of the Internal Revenue Code for taxable years beginning on or
17 after January 1, 1997.

18 (2) Notwithstanding the provisions of paragraph (1), if for any
19 taxable year beginning on or after January 1, 1987, a corporation
20 fails to qualify as an “S corporation” for federal income tax
21 purposes solely because the federal Form 2553 (Election by a
22 Small Business Corporation) was not filed timely, the corporation
23 shall be treated for purposes of this part as an “S corporation” for
24 the taxable year the “S corporation” election should have been
25 made, and for each subsequent year until terminated, if both of the
26 following conditions are met:

27 (A) The corporation and all of its shareholders reported their
28 income for California tax purposes on original returns consistent
29 with “S corporation” status for the year the “S corporation”
30 election should have been made, and for each subsequent taxable
31 year (if any) until terminated.

32 (B) The corporation and its shareholders have filed with the
33 Internal Revenue Service a federal Form 2553 requesting
34 automatic relief with respect to the late “S corporation” election,
35 in full compliance with the federal Revenue Procedure 1997-48,
36 I.R.B. 1997-43, and have received notification of the acceptance
37 of the untimely filed “S corporation” election from the Internal
38 Revenue Service. A copy of the notification shall be provided to
39 the Franchise Tax Board upon request.

(j) The provisions of Section 1362(f) of the Internal Revenue Code, relating to inadvertent invalid elections or terminations, shall apply only for taxable years beginning on or after January 1, 1997, with respect to elections under Section 1362(a) of the Internal Revenue Code for taxable years beginning on or after January 1, 1997.

SEC. 35. *Section 23802 of the Revenue and Taxation Code is amended to read:*

23802. (a) Section 1363(a) of the Internal Revenue Code, relating to the taxability of an “S corporation,” shall not be applicable.

(b) Corporations qualifying under this chapter shall continue to be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except as follows:

(1) The tax imposed under Section 23151 or 23501 shall be imposed at a rate of $1\frac{1}{2}$ percent rather than the rate specified in those sections.

(2) In the case of an “S corporation” which is also a financial corporation, the rate of tax specified in paragraph (1) shall be increased by the excess of the rate imposed under Section 23183 over the rate imposed under Section 23151.

(c) An “S corporation” shall be subject to the minimum franchise tax imposed under Section 23153.

(d) (1) For purposes of subdivision (b), an “S corporation” shall be allowed a deduction under Section 24416 or 24416.1 (relating to net operating loss deductions), but only with respect to losses incurred during periods in which the corporation is an “S corporation” for purposes of this part.

(2) Section 1371(b) of the Internal Revenue Code, relating to denial of carryovers between “C years” and “S years,” shall apply for purposes of the tax imposed under subdivision (b), except as provided in paragraph (1).

(3) The provisions of this subdivision shall not affect the amount of any item of income or loss computed in accordance with the provisions of Section 1366 of the Internal Revenue Code, relating to passthrough items to shareholders.

(4) For purposes of subdivision (b) of Section 17276, relating to limitations on loss carryovers, losses passed through to shareholders of an “S corporation,” to the extent otherwise

allowable without application of that subdivision, shall be fully included in the net operating loss of that shareholder and then that subdivision shall be applied to the entire net operating loss.

(e) For purposes of computing the taxes specified in subdivision (b), an “S corporation” shall be allowed a deduction from income for built-in gains and passive investment income for which a tax has been imposed under this part in accordance with the provisions of Section 1374 of the Internal Revenue Code, relating to tax imposed on certain built-in gains, or Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income.

(f) For purposes of computing taxes imposed under this part, as provided in subdivision (b):

(1) An “S corporation” shall compute its deductions for amortization and depreciation in accordance with the provisions of Part 10 (commencing with Section 17001) of Division 2.

(2) The provisions of Section 465 of the Internal Revenue Code, relating to limitation of deductions to the amount at risk, shall be applied in the same manner as in the case of an individual.

(3) (A) The provisions of Section 469 of the Internal Revenue Code, relating to limitations on passive activity losses and credits, shall be applied in the same manner as in the case of an individual. For purposes of the tax imposed under Section 23151 or 23501, as modified by this section, material participation shall be determined in accordance with Section 469(h) of the Internal Revenue Code, relating to certain closely held “C corporations” and personal service corporations.

(B) For purposes of this paragraph, the “adjusted gross income” of the “S corporation” shall be equal to its “net income,” as determined under Section 24341 with the modifications required by this subdivision, except that no deduction shall be allowed for contributions allowed by Section 24357.

(4) The exclusion provided under Section 18152.5 shall not be allowed to an “S corporation.”

(g) The provisions of Section 1363(d) of the Internal Revenue Code, relating to recapture of LIFO benefits, shall be modified for purposes of this part to refer to Section 19101 in lieu of Section 6601 of the Internal Revenue Code.



SEC. 36. Section 23806 of the Revenue and Taxation Code is amended to read:

23806. (a) Section 1371(a) of the Internal Revenue Code, relating to application of Subchapter C rules, is modified to provide that any election by an “S corporation” or its shareholders under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, for federal income tax purposes shall be treated as an election for purposes of Part 10 (commencing with Section 17001, Part 10.2 (commencing with Section 18401), and this part and a separate election for state purposes shall not be allowed.

(b) No election under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, shall be allowed for state purposes unless the “S corporation” or its shareholders made a valid election for federal income tax purposes under Section 338 of the Internal Revenue Code.

(c) Section 1371 (d) of the Internal Revenue Code shall not apply.

SEC. 37. Section 23811 of the Revenue and Taxation Code is amended to read:

23811. Except as otherwise provided in this section, there is hereby imposed a tax on passive investment income attributable to California sources, determined in accordance with the provisions of Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income, as modified by this section.

(a) The tax imposed under this section shall not be imposed on an “S corporation” that has no excess net passive income for federal income tax purposes determined in accordance with Section 1375 of the Internal Revenue Code.

(b) (1) The rate of tax shall be equal to the rate of tax imposed under Section 23151 in lieu of Section 11(b) of the Internal Revenue Code.

(2) In the case of an “S corporation” which is also a financial corporation, the rate of tax specified in paragraph (1) shall be increased by the excess of the rate imposed under Section 23183 over the rate imposed under Section 23151.

(c) The provisions of Section 1375(c)(1) of the Internal Revenue Code, relating to credits, shall be modified to provide that

1 the tax imposed under subdivision (a) shall not be reduced by any
2 credits allowed under this part.

3 (d) The term “subchapter C earnings and profits” as used in
4 Sections 1362(d)(3) and 1375 of the Internal Revenue Code shall
5 mean the subchapter C earnings and profits of the corporation
6 attributable to California sources determined under this part,
7 modified as provided in subdivision (e).

8 (e) (1) In the case of a corporation which is an “S corporation”
9 for purposes of this part for its first taxable year for which it has
10 in effect a valid federal S election, there shall be allowed as a
11 deduction in determining that corporation’s subchapter C earnings
12 and profits at the close of any taxable year the amount of any
13 consent dividend (as provided in paragraph (2)) paid after the close
14 of that taxable year.

15 (2) In the event there is a determination that a corporation
16 described in paragraph (1) has subchapter C earnings and profits
17 at the close of any taxable year, that corporation shall be entitled
18 to distribute a consent dividend to its shareholders. The amount of
19 the consent dividend shall not exceed the difference between the
20 corporation’s subchapter C earnings and profits determined under
21 subdivision (d) at the close of the taxable year with respect to
22 which the determination is made and the corporation’s subchapter
23 C earnings and profits for federal income tax purposes at the same
24 date. A consent dividend must be paid within 90 days of the date
25 of the determination that the corporation has subchapter C
26 earnings and profits. For this purpose, the date of a determination
27 means the effective date of a closing agreement pursuant to Section
28 19441, the date an assessment of tax imposed by this section
29 becomes final, or the date of execution by the corporation of an
30 agreement with the Franchise Tax Board relating to liability for the
31 tax imposed by this section. For purposes of Part 10 (commencing
32 with Section 17001), Part 10.2 (commencing with Section 18401),
33 and this part, a corporation must make the election provided in
34 Section 1368(e)(3) of the Internal Revenue Code for federal
35 income tax purposes any consent dividend.

36 (3) If a corporation distributes a consent dividend, it shall claim
37 the deduction provided in paragraph (1) by filing a claim therefor
38 with the Franchise Tax Board within 120 days of the date of the
39 determination specified in paragraph (2).

(4) The collection of tax imposed by this section from a corporation described in paragraph (2) shall be stayed for 120 days after the date of the determination specified in paragraph (2). If a claim is filed pursuant to paragraph (3), collection of that tax shall be further stayed until the date the claim is acted upon by the Franchise Tax Board.

(5) If a claim is filed pursuant to paragraph (3), the running of the statute of limitations on the making of assessments and actions for collection of the tax imposed by this section shall be suspended for a period of two years after the date of the determination specified in paragraph (2).

SEC. 37.5. Section 24273 of the Revenue and Taxation Code is amended to read:

24273. Amounts received as loans from the Commodity Credit Corporation shall be considered as income and shall be included in gross income for the taxable year in which received, if the taxpayer has made an election pursuant to Section 77 of the Internal Revenue Code for federal income tax purposes with respect to loans received from the Commodity Credit Corporation.

SEC. 37.7. Section 24306 of the Revenue and Taxation Code is amended to read:

24306. (a) For purposes of this section, the following terms have the following meanings, as provided in the Golden State Scholarshare Trust Act (Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code):

(1) “Beneficiary” has the meaning set forth in subdivision (c) of Section 69980 of the Education Code.

(2) “Benefit” has the meaning set forth in subdivision (d) of Section 69980 of the Education Code.

(3) “Participant” has the meaning set forth in subdivision (h) of Section 69980 of the Education Code.

(4) “Participation agreement” has the meaning set forth in subdivision (i) of Section 69980 of the Education Code.

(5) “Scholarshare trust” has the meaning set forth in subdivision (f) of Section 69980 of the Education Code.

(b) Except as otherwise provided in subdivision (c), gross income of a participant shall not include any of the following:

(1) Any earnings under a Scholarshare trust, or a participation agreement, as provided in Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code.

(2) Contributions to the Scholarshare trust on behalf of a beneficiary shall not be includable as gross income of that beneficiary.

(c) (1) Any distribution under a Scholarshare trust participation agreement shall be includable in the gross income of the distributee in the manner as provided under Section 72 of the Internal Revenue Code, as modified by Section 24272.2, to the extent not excluded from gross income under any other provision of this part. For purposes of applying Section 72 of the Internal Revenue Code, the following apply:

(A) All Scholarshare trust accounts of which an individual is a beneficiary shall be treated as one account, except as otherwise provided.

(B) All distributions during a taxable year shall be treated as one distribution.

(C) The value of the participation agreement, income on the participation agreement, and investment in the participation agreement shall be computed as of the close of the calendar year in which the taxable year begins.

(2) A contribution by a for-profit or nonprofit entity, or by a state or local government agency, for the benefit of an owner or employee of that entity or a beneficiary whom the owner or employee has the power to designate, including the owner or employee's minor children, shall be included in the gross income of that owner or employee in the year the contribution is made.

(3) For purposes of this subdivision, "distribution" includes any benefit furnished to a beneficiary under a participation agreement, as provided in Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code.

(4) (A) Paragraph (1) shall not apply to that portion of any distribution that, within 60 days of distribution, is transferred to the credit of another beneficiary under the Scholarshare trust who is a "member of the family," as that term is used in Section 529(e)(2) of the Internal Revenue Code, as amended by Section 211 of the Taxpayer Relief Act of 1997 (P.L. 105-34), of the former beneficiary of that Scholarshare trust.

(B) Any change in the beneficiary of an interest in the Scholarshare trust shall not be treated as a distribution for purposes of paragraph (1) if the new beneficiary is a "member of the family," as that term is used in Section 2032A(e)(2) of the Internal

1 Revenue Code, of the former beneficiary of that Scholarshare
2 trust.

3 (d) *For taxable years beginning on or after January 1, 2002,*
4 *Sections 529(c) and 529(e) of the Internal Revenue Code, as*
5 *amended by Section 402 of the Economic Growth and Tax Relief*
6 *Reconciliation Act of 2001 (Public Law 107-16) and Section 417*
7 *of the Job Creation and Worker Assistance Act of 2002 (Public*
8 *Law 107-147), shall apply in lieu of subdivisions (b) and (c) of this*
9 *section.*

10 SEC. 38. *Section 24307 of the Revenue and Taxation Code is*
11 *amended to read:*

12 24307. (a) Section 108 of the Internal Revenue Code,
13 relating to income from discharge of indebtedness, shall apply,
14 except as otherwise provided.

15 (b) Section 108(b)(2)(B) of the Internal Revenue Code,
16 relating to general business credit, is modified by substituting
17 “this part” in lieu of “Section 38 (relating to general business
18 credit).”

19 (c) Section 108(b)(2)(G) of the Internal Revenue Code,
20 relating to foreign tax credit carryovers, shall not apply.

21 (d) Section 108(b)(3)(B) of the Internal Revenue Code,
22 relating to credit carryover reduction, is modified by substituting
23 “11.1 cents” in lieu of “33¹/₃ cents” in each place in which it
24 appears. In the case where more than one credit is allowable under
25 this part, the credits shall be reduced on a pro rata basis.

26 (e) Section 108(g)(3)(B) of the Internal Revenue Code,
27 relating to adjusted tax attributes, is modified by substituting “\$9”
28 in lieu of “\$3.”

29 (f) (1) The amendments to Section 108 of the Internal
30 Revenue Code made by Section 13150 of the Revenue
31 Reconciliation Act of 1993 (Public Law 103-66), relating to
32 exclusion from gross income for income from discharge of
33 qualified real property business indebtedness, shall apply to
34 discharges occurring on or after January 1, 1996, in taxable years
35 beginning on or after January 1, 1996.

36 (2) If a taxpayer makes an election for federal income tax
37 purposes under Section 108(c) of the Internal Revenue Code,
38 relating to treatment of discharge of qualified real property
39 business indebtedness, a separate election shall not be allowed and
40 the federal election shall be binding for purposes of this part.



(3) If a taxpayer has not made an election for federal income tax purposes under Section 108(c) of the Internal Revenue Code, relating to treatment of discharge of qualified real property business indebtedness, then the taxpayer shall not be allowed to make that election for purposes of this part.

(g) The amendments to Section 108 of the Internal Revenue Code made by Section 13226 of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to modifications of discharge of indebtedness provisions, shall apply to discharges occurring on or after January 1, 1996, in taxable years beginning on or after January 1, 1996.

SEC. 39. Section 24347.6 is added to the Revenue and Taxation Code, to read:

24347.6. Notwithstanding subdivision (e) of Section 23051.5, a taxpayer may make a separate state election under Section 165(i)(1) of the Internal Revenue Code to take a loss attributable to a disaster into account in the taxable year immediately preceding the taxable year in which the disaster occurred.

SEC. 40. Section 24349 of the Revenue and Taxation Code is amended to read:

24349. (a) There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear, and tear (including a reasonable allowance for obsolescence)—

(1) Of property used in the trade or business; or

(2) Of property held for the production of income.

(b) Except as otherwise provided in subdivision (c), for taxable years ending after December 31, 1958, the term “reasonable allowance” as used in subdivision (a) shall include, but shall not be limited to, an allowance computed in accordance with regulations prescribed by the Franchise Tax Board, under any of the following methods:

(1) The straight-line method.

(2) The declining balance method, using a rate not exceeding twice the rate that would have been used had the annual allowance been computed under the method described in paragraph (1).

(3) The sum of the years-digits method.

(4) Any other consistent method productive of an annual allowance that, when added to all allowances for the period commencing with the taxpayer’s use of the property and including the taxable year, does not, during the first two-thirds of the useful

1 life of the property, exceed the total of those allowances that would
2 have been used had those allowances been computed under the
3 method described in paragraph (2).

4 Nothing in this subdivision shall be construed to limit or reduce
5 an allowance otherwise allowable under subdivision (a).

6 (c) Any grapevine replaced in a vineyard in California in a
7 taxable year beginning on or after January 1, 1992, as a direct
8 result of a phylloxera infestation in that vineyard, and any
9 grapevine replaced in a vineyard in California in a taxable year
10 beginning on or after January 1, 1997, as a direct result of Pierce's
11 disease in that vineyard, shall have a useful life of five years,
12 except that it shall have a class life of 10 years for purposes of
13 depreciation under Section 168(g)(2) of the Internal Revenue
14 Code where the taxpayer has made an election under Section
15 263A(d)(3) of the Internal Revenue Code not to capitalize costs of
16 the infested vineyard. Every taxpayer claiming a deduction under
17 this section with respect to a grapevine as described in this
18 subdivision shall obtain a written certification from an
19 independent state-certified integrated pest management adviser, or
20 a state agricultural commissioner or adviser, that specifies that the
21 replanting was necessary to restore a vineyard infested with
22 phylloxera or Pierce's disease. The taxpayer shall retain the
23 certification for future audit purposes.

24 (d) For purposes of this part, the deduction for property leased
25 to governments and other tax-exempt entities, as defined in
26 Section 168(h) of the Internal Revenue Code, shall be limited to
27 the amount determined under Section 168(g) of the Internal
28 Revenue Code, relating to alternative depreciation system for
29 certain property.

30 (e) (1) In the case of any building erected or improvements
31 made on leased property, if the building or improvement is
32 property to which this section applies, the depreciation deduction
33 shall be determined under the provisions of this section.

34 (2) An improvement shall be treated for purposes of
35 determining gain or loss under this part as disposed of by the lessor
36 when so disposed of or abandoned if both of the following occur:

37 (A) The improvement is made by the lessor of leased property
38 for the lessee of that property.

39 (B) The improvement is irrevocably disposed of or abandoned
40 by the lessor at the termination of the lease by the lessee.

1 This subdivision shall not apply to any property to which
2 Section 168 of the Internal Revenue Code does not apply for
3 federal income tax purposes by reason of Section 168(f) of the
4 Internal Revenue Code. Any election made under Section
5 168(f)(1) of the Internal Revenue Code for federal income tax
6 purposes with respect to that property shall be treated as a binding
7 election for state purposes under this subdivision with respect to
8 that same property and no separate election with respect to that
9 property shall be allowed.

10 (3) (A) In determining a lease term, both of the following shall
11 apply:

12 (i) There shall be taken into account options to renew.

13 (ii) Two or more successive leases which are part of the same
14 transaction (or a series of related transactions) with respect to the
15 same or substantially similar property shall be treated as one lease.

16 (B) For purposes of clause (i) of subparagraph (A), in the case
17 of nonresidential real property or residential rental property, there
18 shall not be taken into account any option to renew at fair market
19 value determined at the time of renewal.

20 (f) (1) Section 167(g) of the Internal Revenue Code, relating
21 to depreciation under income forecast method, shall apply except
22 as otherwise provided.

23 (2) Section 167(g)(2)(C) of the Internal Revenue Code is
24 modified by substituting “Section 19521” in lieu of “Section
25 460(b)(7)” of the Internal Revenue Code.

26 (3) Section 167(g)(5)(D) of the Internal Revenue Code is
27 modified by substituting “Part 10.2 (commencing with Section
28 18401) (other than Article 2 (commencing with Section 19021)
29 and Sections 19142 to 19150, inclusive)” in lieu of “Subtitle F
30 (other than Sections 6654 and 6655).”

31 *SEC. 41. Section 24355.5 of the Revenue and Taxation Code*
32 *is amended to read:*

33 24355.5. (a) Section 197 of the Internal Revenue Code,
34 relating to amortization of goodwill and certain other intangibles,
35 shall apply, except as otherwise provided.

36 (b) (1) Section 13261(g) of the Revenue Reconciliation Act of
37 1993 (Public Law 103-66), relating to effective dates, shall apply,
38 except as otherwise provided.

39 (2) (A) If a taxpayer has, at any time, made an election for
40 federal income tax purposes under Section 13261(g)(2) of the

Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to election to have amendments apply to property acquired after July 25, 1991, or Section 13261(g)(3) of that act, relating to elective binding contract exception, a separate election for state purposes shall not be allowed and the federal election shall be binding for purposes of this part.

(B) If a taxpayer has not made an election for federal income tax purposes under Section 13261(g)(2) of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to election to have amendments apply to property acquired after July 25, 1991, or Section 13261(g)(3) of that act, relating to elective binding contract exception, with respect to property acquired before August 11, 1993, then the taxpayer shall not be allowed to make an election under Section 13261(g) of the Revenue Reconciliation Act of 1993 (Public Law 103-66), for purposes of this part, with respect to that property.

(c) Notwithstanding any other provision of this section, each of the following shall apply:

(1) No deduction shall be allowed under this section for any taxable year beginning prior to January 1, 1994.

(2) No inference is intended with respect to the allowance or denial of any deduction for amortization in any taxable year beginning before January 1, 1994.

(3) In the case of an intangible that was acquired in an taxable year beginning before January 1, 1994, the amount to be amortized shall not exceed the adjusted basis of that intangible as of the first day of the first taxable year beginning on or after January 1, 1994, and that amount shall be amortized ratably over the period beginning with the first month of the first taxable year beginning on or after January 1, 1994, and ending 15 years after the month in which the intangible was acquired.

SEC. 41.2. Section 24357 of the Revenue and Taxation Code is amended to read:

24357. (a) There shall be allowed as a deduction any charitable contribution (as defined in Section 24359) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Franchise Tax Board.

(b) In the case of a corporation reporting its income on the accrual basis, the corporation shall treat the contribution as paid

1 during that taxable year if the corporation has made an election
2 pursuant to Section 170(a)(2) of the Internal Revenue Code,
3 relating to corporations on accrual basis, for federal income tax
4 purposes with respect to that contribution.

5 (c) For purposes of this section, payment of a charitable
6 contribution that consists of a future interest in tangible personal
7 property shall be treated as made only when all intervening
8 interests in, and rights to the actual possession or enjoyment of, the
9 property have expired or are held by persons other than the
10 taxpayer or those standing in a relationship to the taxpayer
11 described in Section 24428. For purposes of the preceding
12 sentence, a fixture which is intended to be severed from the real
13 property shall be treated as tangible personal property.

14 (d) No deduction shall be allowed under this section for
15 traveling expenses (including amounts expended for meals and
16 lodging) while away from home, whether paid directly or by
17 reimbursement, unless there is no significant element of personal
18 pleasure, recreation, or vacation in that travel.

19 (e) (1) Section 170(f)(8) of the Internal Revenue Code,
20 relating to substantiation requirement for certain contributions,
21 shall apply, except as otherwise provided.

22 (2) No deduction shall be denied under Section 170(f)(8) of the
23 Internal Revenue Code, relating to substantiation requirement for
24 certain contributions, upon a showing that the requirements in
25 Section 170(f)(8) of the Internal Revenue Code have been met
26 with respect to that contribution for federal purposes.

27 *SEC. 41.4. Section 24362 of the Revenue and Taxation Code*
28 *is amended to read:*

29 24362. Sections 24360 to 24363.5, inclusive, shall apply to
30 the bonds only if the taxpayer has made the election pursuant to
31 Section 171(c) of the Internal Revenue Code for federal income
32 tax purposes to have Section 171 of the Internal Revenue Code,
33 relating to amortizable bond premium, apply for federal income
34 tax purposes to the bonds.

35 *SEC. 41.6. Section 24364 of the Revenue and Taxation Code*
36 *is amended to read:*

37 24364. Notwithstanding Article 3 (commencing with Section
38 24421), all expenditures (other than expenditures for the purchase
39 of land or depreciable property or for the acquisition of circulation
40 through the purchase of any part of the business of another

1 publisher of a newspaper, magazine, or other periodical) to
2 establish, maintain, or increase the circulation of a newspaper,
3 magazine, or other periodical shall be allowed as a deduction.
4 However, the deduction shall not be allowed with respect to the
5 portion of the expenditures that the taxpayer has elected, pursuant
6 to Section 173 of the Internal Revenue Code, to treat as chargeable
7 to capital account for federal income tax purposes.

8 *SEC. 42. Section 24369.4 of the Revenue and Taxation Code*
9 *is amended to read:*

10 24369.4. (a) Section 198 of the Internal Revenue Code,
11 relating to expensing of environmental remediation costs, shall
12 apply, except as otherwise provided.

13 (b) Section 198(b)(2) is modified to refer to Sections 24349 to
14 24355, inclusive, in lieu of Section 167 of the Internal Revenue
15 Code.

16 (c) Section 198(f) is modified to refer to Section 24442 in lieu
17 of Section 280B of the Internal Revenue Code.

18 (d) (1) If a taxpayer has, at any time, made an election for
19 federal income tax purposes under Section 198(a) of the Internal
20 Revenue Code to have Section 198 of the Internal Revenue Code
21 apply to a qualified environmental remediation expenditure,
22 Section 198 of the Internal Revenue Code shall apply to that
23 qualified environmental remediation expenditure for state
24 purposes, a separate election for state purposes shall not be
25 allowed and the federal election shall be binding for purposes of
26 this part.

27 (2) If a taxpayer fails to make an election for federal income tax
28 purposes under Section 198(a) of the Internal Revenue Code to
29 have Section 198 of the Internal Revenue Code apply to a qualified
30 environmental remediation expenditure, an election under Section
31 198(a) of the Internal Revenue Code shall not be allowed for state
32 purposes, Section 198 of the Internal Revenue Code shall not apply
33 to that qualified environmental remediation expenditure for state
34 purposes, and a separate election for state purposes shall not be
35 allowed.

36 (e) No inference as to the proper treatment for purposes of this
37 part of qualified environmental remediation expenditures for
38 periods before the enactment of this section shall be made.

39 *SEC. 42.2. Section 24377 of the Revenue and Taxation Code*
40 *is repealed.*

1 *SEC. 42.4. Section 24377 is added to the Revenue and*
2 *Taxation Code, to read:*

3 24377. *Section 180 of the Internal Revenue Code, relating to*
4 *expenditures by farmers for fertilizer, etc., shall apply, except as*
5 *otherwise provided.*

6 *SEC. 42.6. Section 24407 of the Revenue and Taxation Code*
7 *is amended to read:*

8 24407. The organizational expenditures of a corporation shall
9 be treated as deferred expenses if the corporation has made an
10 election pursuant to Section 248 of the Internal Revenue Code for
11 federal income tax purposes with respect to those expenses. In
12 computing net income, the deferred expenses shall be allowed as
13 a deduction ratably over that period of not less than 60 months as
14 has been selected by the corporation (beginning with the month in
15 which the corporation begins business) for federal income tax
16 purposes pursuant to Section 248 of the Internal Revenue Code.

17 *SEC. 42.8. Section 24409 of the Revenue and Taxation Code*
18 *is amended to read:*

19 24409. The period that applies under Section 24407 shall be
20 adhered to in computing the income of the corporation for the
21 taxable year for which the election is made pursuant to Section 248
22 of the Internal Revenue Code for federal income tax purposes with
23 respect to those expenses and all subsequent taxable years.

24 *SEC. 43. Section 24423 of the Revenue and Taxation Code is*
25 *amended to read:*

26 24423. (a) Notwithstanding Section 24422, regulations shall
27 be prescribed by the Franchise Tax Board under this part
28 corresponding to the regulations which granted the option to
29 deduct as expenses intangible drilling and development costs in
30 the case of oil and gas wells and which were recognized and
31 approved by the Congress in House Concurrent Resolution 50,
32 Seventy-ninth Congress.

33 (b) Section 263(i) of the Internal Revenue Code, relating to
34 special rules for intangible drilling and development costs
35 incurred outside the United States, shall apply, except as otherwise
36 provided.

37 *SEC. 43.2. Section 24426 of the Revenue and Taxation Code*
38 *is amended to read:*

39 24426. Amounts paid or accrued for such taxes and carrying
40 charges as, pursuant to an election under Section 266 of the

Internal Revenue Code for federal income tax purposes, are chargeable to capital account with respect to property.

SEC. 43.4. Section 24651 of the Revenue and Taxation Code is amended to read:

24651. (a) Income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes its income in keeping its books and utilizes for federal income tax purposes if the taxpayer has a federal income tax filing requirement.

(b) If the taxpayer has no federal income tax filing requirement and no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of income shall be made under such method as, in the opinion of the Franchise Tax Board, does clearly reflect income.

(c) Subject to subdivisions (a) and (b) and Section 24654, a taxpayer may compute income under any of the following methods of accounting—

(1) The cash receipts and disbursements method;

(2) An accrual method;

(3) Any other method permitted by this part; or

(4) Any combination of the foregoing methods permitted under regulations prescribed by the Franchise Tax Board.

(d) A taxpayer engaged in more than one trade or business may in computing income, use a different method of accounting for each trade or business, but the method used shall be the same as the method used for federal income tax purposes for that trade or business. If the trade or business is not subject to federal income tax, then the taxpayer shall use the method of accounting on the basis that the taxpayer regularly computes the income for that trade or business in keeping its books, subject to subdivision (b).

(e) Except as otherwise expressly provided in this part, a taxpayer who changes the method of accounting on the basis of which it regularly computes its income in keeping its books shall, before computing its income under the new method, secure the consent of the Franchise Tax Board. Any change in method of accounting granted or required for federal income tax purposes shall be binding for purposes of this part, and the change will apply automatically without the requirement for consent by the Franchise Tax Board. However, the Franchise Tax Board may make proper adjustments to any adjustments required by changes

1 in accounting under Section 481 of the Internal Revenue Code and
2 Section 24721. Adjustments computed under Section 481 of the
3 Internal Revenue Code and Section 24721 shall take into account
4 differences in federal and California law.

5 (f) If the taxpayer is required to and does not file with the
6 Franchise Tax Board a request to change the method of accounting,
7 the absence of the consent of the Franchise Tax Board to a change
8 in the method of accounting shall not be taken into account for
9 either of the following:

10 (1) To prevent the imposition of any penalty, or the addition of
11 any amount to tax, under this part.

12 (2) To diminish the amount of that penalty or addition to tax.

13 *SEC. 43.6. Section 24674 of the Revenue and Taxation Code*
14 *is amended to read:*

15 24674. (a) If, in the case of a taxpayer owning any
16 non-interest-bearing obligation issued at a discount and
17 redeemable for fixed amounts increasing at stated intervals, the
18 increase in the redemption price of the obligation occurring in the
19 taxable year does not (under the method of accounting used in
20 computing its income) constitute income to it in the taxable year,
21 the taxpayer shall treat the increase as income received in the
22 taxable year if the taxpayer has made an election pursuant to
23 Section 454 of the Internal Revenue Code for federal tax purposes.
24 If the preceding sentence applies with respect to any obligation
25 described in that sentence, it shall also apply to all obligations
26 described in that sentence owned by the taxpayer at the beginning
27 of the first taxable year to which it applies and to all obligations
28 described in that sentence thereafter acquired by it and shall be
29 binding for all subsequent taxable years that the taxpayer's
30 election pursuant to Section 454 of the Internal Revenue Code
31 remains in effect for federal income tax purposes.

32 (b) In the case of any obligation—

33 (1) Of the United States; or

34 (2) Of a state, a territory, or a possession of the United States,
35 or any political subdivision of any of the foregoing, or of the
36 District of Columbia, which is issued on a discount basis and
37 payable without interest at a fixed maturity date not exceeding one
38 year from the date of issue, the amount of discount at which such
39 obligation is originally sold shall not be considered to accrue until

1 the date on which such obligation is paid at maturity, sold, or
2 otherwise disposed of.

3 *SEC. 43.8. Section 24676 of the Revenue and Taxation Code*
4 *is repealed.*

5 *SEC. 44. Section 24676 is added to the Revenue and Taxation*
6 *Code, to read:*

7 24676. (a) *Section 455 of the Internal Revenue Code,*
8 *relating to prepaid subscription income, shall apply, except as*
9 *otherwise provided.*

10 (b) *Section 455(b)(2) of the Internal Revenue Code is modified*
11 *by substituting the phrase “If the taxpayer ceases to be subject to*
12 *tax measured by net income imposed under Chapter 2*
13 *(commencing with Section 23101) or Chapter 3 (commencing with*
14 *Section 23501) of this part” for the phrase “If the taxpayer dies or*
15 *ceases to exist” contained therein.*

16 (c) *Section 455(b)(2) of the Internal Revenue Code is modified*
17 *by substituting the phrase “shall be included in the measure of tax*
18 *for the last year in which the taxpayer is subject to the tax measured*
19 *by net income imposed under Chapter 2 (commencing with Section*
20 *23101) or Chapter 3 (commencing with Section 23501) of this*
21 *part” for the phrase “shall be included in gross income for the*
22 *taxable year in which such death, or such cessation of existence,*
23 *occurs” contained therein.*

24 *SEC. 44.2. Section 24676.5 of the Revenue and Taxation Code*
25 *is repealed.*

26 *SEC. 44.6. Section 24676.5 is added to the Revenue and*
27 *Taxation Code, to read:*

28 24676.5. (a) *Section 458 of the Internal Revenue Code,*
29 *relating to magazines, paperbacks, and records returned after the*
30 *close of the taxable year, shall apply, except as otherwise provided.*

31 (b) *Section 458(d) of the Internal Revenue Code is modified by*
32 *substituting “Section 24723” for “section 481(c)” and*
33 *“subdivision (b) of Section 24721” and “section 481(a)(2).”*

34 (c) *Section 458(e)(1) of the Internal Revenue Code is modified*
35 *by substituting “Sections 24721 to 24725, inclusive,” for “section*
36 *481.”*

37 *SEC. 44.8. Section 24710 of the Revenue and Taxation Code*
38 *is amended to read:*

39 24710. (a) *For each taxable year beginning on or after*
40 *January 1, 1997, Section 475 of the Internal Revenue Code,*

1 relating to mark to market accounting method for securities
2 dealers, shall apply, except as otherwise provided.

3 (b) Section 13233(c)(2)(C) of the Revenue Reconciliation Act
4 of 1993 (Public Law 103-66), relating to the effective date for
5 changes in the mark to market accounting method for securities
6 dealers, is modified to provide that the amount taken into account
7 under Section 481 of the Internal Revenue Code of 1986 shall be
8 taken into account ratably over the five-taxable-year period
9 beginning with the first taxable year beginning on or after January
10 1, 1997.

11 (c) (1) If a taxpayer has, at any time, made an election for
12 federal income tax purposes under Section 475(e) of the Internal
13 Revenue Code, relating to election of mark to market for dealers
14 in commodities, to have Section 475 of the Internal Revenue Code
15 apply, Section 475 of the Internal Revenue Code shall apply to that
16 dealer in commodities for state purposes, a separate election for
17 state purposes shall not be allowed and the federal election shall
18 be binding for purposes of this part.

19 (2) If a taxpayer fails to make, or has not previously made, an
20 election for federal income tax purposes under Section 475(e) of
21 the Internal Revenue Code, relating to election of mark to market
22 for dealers in commodities, to have Section 475 of the Internal
23 Revenue Code apply, an election under Section 475(e) of the
24 Internal Revenue Code shall not be allowed for state purposes,
25 Section 475 of the Internal Revenue Code shall not apply to that
26 dealer in commodities for state purposes, and a separate election
27 for state purposes shall not be allowed.

28 (d) (1) If a taxpayer has, at any time, made an election for
29 federal income tax purposes under Section 475(f)(1) of the
30 Internal Revenue Code, relating to election of mark to market for
31 traders in securities, to have Section 475 of the Internal Revenue
32 Code apply to a trade or business, Section 475 of the Internal
33 Revenue Code shall apply to that trader in securities for state
34 purposes with respect to that trade or business, a separate election
35 for state purposes with respect to that trade or business shall not be
36 allowed and the federal election shall be binding for purposes of
37 this part.

38 (2) If a taxpayer fails to make, or has not previously made, an
39 election for federal income tax purposes under Section 475(f)(1)
40 of the Internal Revenue Code, relating to election of mark to

market for traders in securities, to have Section 475 of the Internal Revenue Code apply to a trade or business, an election under Section 475(f)(1) of the Internal Revenue Code shall not be allowed for state purposes with respect to that trade or business, Section 475 of the Internal Revenue Code shall not apply to that trader in securities for state purposes with respect to that trade or business, and a separate election for state purposes shall not be allowed.

(e) (1) If a taxpayer has, at any time, made an election for federal income tax purposes under Section 475(f)(2) of the Internal Revenue Code, relating to election of mark to market for traders in commodities, to have Section 475 of the Internal Revenue Code apply to a trade or business, Section 475 of the Internal Revenue Code shall apply to that trader in commodities for state purposes with respect to that trade or business, a separate election for state purposes with respect to that trade or business shall not be allowed and the federal election with respect to that trade or business shall be binding for purposes of this part.

(2) If a taxpayer fails to make, or has not previously made, an election for federal income tax purposes under Section 475(f)(2) of the Internal Revenue Code, relating to election of mark to market for traders in commodities, to have Section 475 of the Internal Revenue Code apply to a trade or business, an election under Section 475(f)(2) of the Internal Revenue Code shall not be allowed for state purposes with respect to that trade or business, Section 475 of the Internal Revenue Code shall not apply to that trader in commodities for state purposes with respect to that trade or business, and a separate election for state purposes with respect to that trade or business shall not be allowed.

(f) (1) An election under Section 475(e) or (f) of the Internal Revenue Code made for federal income tax purposes with respect to a taxable year beginning before January 1, 1998, shall be treated as having been made for state purposes with respect to the first taxable year beginning on or after January 1, 1998.

(2) Section 1001(d)(4)(B) of the Taxpayer Relief Act of 1997 (Public Law 105-34), relating to the effective date for election of mark to market by securities traders and traders and dealers in commodities, is modified to provide that the requirement for timely identification shall be treated as timely made for state purposes if that identification is treated as timely made for federal

1 income tax purposes, and the amount taken into account under
2 Section 481 of the Internal Revenue Code of 1986 shall be taken
3 into account ratably over the four-taxable-year period beginning
4 with the first taxable year beginning on or after January 1, 1998.

5 *SEC. 45. Section 24872.4 of the Revenue and Taxation Code*
6 *is amended to read:*

7 24872.4. (a) Section 856(d)(7)(C)(ii) of the Internal
8 Revenue Code is modified by substituting the phrase “if received
9 by an organization described in subdivision (b) of Section 17651
10 of Part 10 or Section 23731” for the phrase “if received by an
11 organization described in section 511(a)(2).”

12 (b) (1) An election under Section 856(e)(5) of the Internal
13 Revenue Code for federal income tax purposes shall be treated for
14 purposes of this part as an election made by the real estate
15 investment trust under Section 856(e)(5) of the Internal Revenue
16 Code for state purposes and a separate election shall not be
17 allowed.

18 (2) Any revocation of an election under Section 856(e)(5) of
19 the Internal Revenue Code for federal income tax purposes shall
20 be treated for purposes of this part as a revocation of the election
21 made by the real estate investment trust under Section 856(e)(5)
22 of the Internal Revenue Code for state purposes and a separate
23 election shall not be allowed with respect to the property for any
24 subsequent taxable year.

25 (3) If the real estate investment trust fails to make an election
26 under Section 856(e)(5) of the Internal Revenue Code for federal
27 income tax purposes with respect to any property, that property
28 shall not be treated for purposes of this part as foreclosure
29 property, an election under Section 856(e)(5) of the Internal
30 Revenue Code for state purposes with respect to that property shall
31 not be allowed, and a separate election shall not be allowed with
32 respect to that property.

33 (c) This section shall apply to taxable years beginning after
34 August 5, 1997.

35 (d) The amendments made to this section by the act adding this
36 subdivision shall apply to taxable years beginning on or after
37 January 1, 1998.

38 *SEC. 46. Section 24944 of the Revenue and Taxation Code is*
39 *amended to read:*

24944. If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in subdivision (b) of Section 24943) occurred after December 31, 1952, the gain (if any) shall be recognized except to the extent hereinafter provided in this section:

(a) If the taxpayer during the period specified in subdivision (b), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning replacement property and the taxpayer has made an election pursuant to Section 1033(a)(2)(A) of the Internal Revenue Code for federal income tax purposes, the gain shall be recognized only to the extent that the amount realized upon the conversion (regardless of whether that amount is received in one or more taxable years) exceeds the cost of the replacement property or stock. For purposes of this subdivision—

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing the converted property unless held by the taxpayer on the date of such disposition; and

(2) The taxpayer shall be considered to have purchased property or stock only if, but for the provisions of Section 24947, the unadjusted basis of the replacement property or stock would be its cost within the meaning of Section 24912.

(b) The period referred to in subdivision (a) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(1) Two years after the close of the first taxable year in which any part of the gain upon the conversion is realized; or

(2) Subject to any terms and conditions as may be specified by the Franchise Tax Board, at the close of a later date as the Franchise Tax Board may designate on application by the taxpayer. The application shall be made at the time and in manner as the Franchise Tax Board may prescribe.

(c) For purposes of this section and Section 24943, replacement property “similar or related in service or use” shall include, in the case of a nonprofit water utility corporation, personal property used for the transmission or storage of water.

SEC. 47. Section 24946 of the Revenue and Taxation Code is amended to read:

24946. If subdivision (a) of Section 24944 applies to the taxpayer, and the replacement property or stock was purchased before the beginning of the last taxable year in which any part of the gain upon the conversion is realized, any deficiency, to the extent resulting from the application of subdivision (a) of Section 24944, for any taxable year ending before that last taxable year may be assessed (notwithstanding the provisions of Section 19057 or the provisions of any other law or rule of law which would otherwise prevent the assessment) at any time before the expiration of the period within which a deficiency for that last taxable year may be assessed.

SEC. 48. Section 24949.2 of the Revenue and Taxation Code is amended to read:

24949.2. (a) For purposes of Sections 24943 through 24945, if real property (not including stock in trade or other property held primarily for sale) held for productive use in trade or business or for investment is (as a result of its seizure, requisition, or condemnation, or threat or imminence thereof) compulsorily or involuntarily converted, property of a like kind to be held either for productive use in trade or business or for investment shall be treated as property similar or related in service or use to the property so converted.

(b) (1) Subdivision (a) shall not apply to the purchase of stock in the acquisition of control of a corporation described in subdivision (a) of Section 24944.

(2) Subdivision (a) shall apply with respect to the compulsory or involuntary conversion of any real property only if the disposition of the converted property (within the meaning of subdivision (b) of Section 24943) occurs after December 31, 1960.

(c) (1) A taxpayer may elect, at such time and in such manner as the Franchise Tax Board may prescribe, to treat property which constitutes an outdoor advertising display as real property for purposes of this part with respect to which an election under

1 Section 24356.6, 24356.7, or 24356.8 (relating to election to
2 expense certain depreciable business assets) is in effect.

3 (2) An election made under paragraph (1) may not be revoked
4 without the consent of the Franchise Tax Board.

5 (3) For purposes of this subdivision, the term “outdoor
6 advertising display” means a rigidly assembled sign, display, or
7 device permanently affixed to the ground or permanently attached
8 to a building or other inherently permanent structure constituting,
9 or used for the display of, a commercial or other advertisement to
10 the public.

11 (4) For purposes of this subdivision, an interest in real property
12 purchased as replacement property for a compulsorily or
13 involuntarily converted outdoor advertising display defined in
14 paragraph (3) (and treated by the taxpayer as real property) shall
15 be considered property of a like kind as the property converted
16 without regard to whether the taxpayer’s interest in the
17 replacement property is the same kind of interest the taxpayer held
18 in the converted property.

19 (d) In the case of a compulsory or involuntary conversion
20 described in subdivision (a), paragraph (1) of subdivision (b) of
21 Section 24944 shall be applied by substituting “three years” for
22 “two years.”

23 (e) Subdivision (d) shall apply with respect to any disposition
24 of converted property (within the meaning of Section 24944) after
25 December 31, 1976.

26 *SEC. 49. (a) Except for the changes made by this act to*
27 *Section 23801 of the Revenue and Taxation Code that require a*
28 *corporation that has in effect for federal income tax purposes a*
29 *valid election under Section 1362(a) of the Internal Revenue Code*
30 *to be an S corporation for purposes of Part 10 (commencing with*
31 *Section 17001), Part 10.2 (commencing with Section 18401), and*
32 *Part 11 (commencing with Section 23001) of the Revenue and*
33 *Taxation Code, it is the intent of the Legislature that this act not*
34 *be construed in a manner that would require any taxpayer that has*
35 *made, or has in effect, a valid separate state election or a valid*
36 *separate state method of accounting to change that election or*
37 *method to be the same as that taxpayer’s election or method for*
38 *federal income tax purposes. The preceding sentence shall only*
39 *apply to any election or method that has been made or is in effect*
40 *for taxable years beginning before January 1, 2002.*

(b) (1) A taxpayer that has made, or has in effect, a valid separate state election or a valid separate state method of accounting under Sections 17024.5 or 23051.5 of the Revenue and Taxation Code, as in effect for taxable years beginning before January 1, 2002, may, in the form and manner in which the Franchise Tax Board may specify in forms and instructions, elect or otherwise apply to the Franchise Tax Board for consent under this subdivision to have that taxpayer's federal election or federal method of accounting apply for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), or Part 11 (commencing with Section 23001) of the Revenue and Taxation Code.

(2) In the case of any taxpayer making the election or application for consent allowed under paragraph (1) to apply the taxpayer's federal election or method of accounting for any taxable year beginning on or after January 1, 2002, for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), or Part 11 (commencing with Section 23001) of the Revenue and Taxation Code, the following rules shall apply to that election or application for consent:

(A) The change shall be treated as initiated by the taxpayer.

(B) The change shall be treated as made with the consent of the Franchise Tax Board.

(C) The net amount of the adjustments required to be taken into account under Section 481 of the Internal Revenue Code, as applicable for purposes of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) of the Revenue and Taxation Code, shall be taken into account ratably over the four-taxable-year period beginning with the first taxable year for which the election or application for consent is effective under this subdivision.

SEC. 50. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect. Sections 17052.6, 17085, 17140, 17140.3, 17144.5, 17205, 17501, 17551, 23701s, 23705, 23711, 23712, and 24306 of the Revenue and Taxation Code, as amended or added by this act, conform, in whole or in part, to the changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), and Subtitle B of Title IV of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), to the Internal

1 *Revenue Code and shall be operative with respect to the same*
2 *period as the federal law provision to which it conforms.*

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**All matter omitted in this version of the
bill appears in the bill as amended in the
Senate March 20, 2002. (JR 11)**

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